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 **March 2014**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

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

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(63 DOCUMENTS)

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 232

[Release Nos. 33-9554; 34-71643; 39-2496; IC-30972]

Adoption of Updated EDGAR Filer Manual

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the Commission) is adopting revisions to the Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) Filer Manual and related rules to reflect updates to the EDGAR system. The revisions are being made primarily to introduce new submission form types MA, MA-A, MA/A, MA-I, MA-I/A, and MA-W to support Registration of Municipal Advisors; updates to submission form types 8-K, 8-K/A, 10-K, 10-K/A, 10-KT, 10-KT/A, 10-D, 10-D/A, POS AM, 424B1, 424B2, 424B3, 424B4, 424B5, 424B7, and 424B8; and minor updates to Form 13F validations. The EDGAR system is scheduled to be upgraded to support this functionality on March 3, 2014.

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

FOR FURTHER INFORMATION CONTACT: In the Office of Municipal Securities, for questions concerning Registration of Municipal Advisors contact Jessica Kane at (202) 551-3235; in the Division of Investment Management, for questions concerning Form 13F contact Heather Fernandez at (202) 551-6715; and in the Office of Information Technology, contact Vanessa Anderson at (202) 551-8800.

SUPPLEMENTARY INFORMATION: We are adopting an updated EDGAR Filer Manual, Volume I and Volume II. The Filer Manual describes the technical formatting requirements for the preparation and submission of electronic filings through the EDGAR system.[1] It also describes the requirements for filing using EDGARLink Online and the Online Forms/XML website.

The revisions to the Filer Manual reflect changes within Volume I entitled EDGAR Filer Manual, Volume I: "General Information," Version 16 (March 2014) and Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 26 (March 2014). The updated manual will be incorporated by reference into the Code of Federal Regulations.

The Filer Manual contains all the technical specifications for filers to submit filings using the EDGAR system. Filers must comply with the applicable provisions of the Filer Manual in order to assure the timely acceptance and processing of filings made in electronic format.[2] Filers may consult the Filer Manual in conjunction with our rules governing mandated electronic filing when preparing documents for electronic submission.[3]

The EDGAR system will be upgraded to Release 14.0 on March 3, 2014 and will introduce the following changes: EDGAR will be updated to add new submission form types MA, MA-A, MA/A, MA-I, MA-I/A, and MA-W on the EDGAR Filing Website. These submission form types can be accessed by selecting the 'File Municipal Advisor Forms' link available on the EDGAR Filing Website. Instructions to file the Municipal Advisor Forms are included in two new sections of Chapter 9 (Preparing and Transmitting Online Submissions) of the "EDGAR Filer Manual,

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[1] We originally adopted the Filer Manual on April 1, 1993, with an effective date of April 26, 1993. Release No. 33-6986 (April 1, 1993) [58 FR 18638]. We implemented the most recent update to the Filer Manual on September 25, 2013. See Release No. 33-9457 (October 2, 2013) [78 FR 60684].

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

[3] See Release No. 33-9457 in which we implemented EDGAR Release 13.3. For additional history of Filer Manual rules, please see the cites therein.

Volume II: EDGAR Filing" to guide filers through the filing process. See Release No. 34-70462[4] for the compliance dates.

Submission form types 8-K, 8-K/A, 10-K, 10-K/A, 10-KT, 10-KT/A, 10-D, 10-D/A, POS AM, 424B1, 424B2, 424B3, 424B4, 424B5, 424B7, and 424B8 will be updated to collect Depositor CIK, Sponsor CIK, ABS Asset Class, and ABS Sub Asset Class information for filings where the primary registrant CIK is designated as an Asset-Backed Securities issuing entity (i.e., entities assigned the Standard Industrial Classification Code 6189).

Submission form types 13F-HR/A will be updated to allow a future date for the "Date denied or on which confidential treatment expired" field.

For EDGARLink Online application, recommended version for Firefox browser is being changed from 3.5 to 17.0 or higher. For all EDGAR websites, Microsoft Internet Explorer 7.0 or later is the recommended browser. Additionally, minor documentation only corrections were made to the Chapter 6, Interactive Data, sections 6.5.20 and 6.6.29.

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

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

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[4] See Release No. 34-70462 (September 20, 2013) [78 FR 67467 (November 12, 2013)].

Since the Filer Manual and the corresponding rule changes relate solely to agency procedures or practice, publication for notice and comment is not required under the Administrative Procedure Act (APA).[5] It follows that the requirements of the Regulatory Flexibility Act[6] do not apply.

The effective date for the updated Filer Manual and the rule amendments is [Insert date of publication in the Federal Register]. In accordance with the APA,[7] we find that there is good cause to establish an effective date less than 30 days after publication of these rules. The EDGAR system upgrade to Release 14.0 is scheduled to become available on March 3, 2014. The Commission believes that establishing an effective date less than 30 days after publication of these rules is necessary to coordinate the effectiveness of the updated Filer Manual with the system upgrade.

Statutory Basis

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

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

[6] 5 U.S.C. 601 - 612.

[7] 5 U.S.C. 553(d)(3).

[8] 15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a).

[9] 15 U.S.C. 78c, 78l, 78m, 78n, 78o, 78w, and 78ll.

[10] 15 U.S.C. 77sss.

[11] 15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37.

List of Subjects in 17 CFR Part 232

Incorporation by reference, Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENT

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

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

1. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z–3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a–6(c), 80a–8, 80a–29, 80a–30, 80a–37, and 7201 et seq.; and 18 U.S.C. 1350.

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2. Section 232.301 is revised to read as follows:

§232.301 EDGAR Filer Manual.

Filers must prepare electronic filings in the manner prescribed by the EDGAR Filer Manual, promulgated by the Commission, which sets out the technical formatting requirements for electronic submissions. The requirements for becoming an EDGAR Filer and updating company data are set forth in the updated EDGAR Filer Manual, Volume I: "General Information," Version 16 (March 2014). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 26 (March 2014). Additional provisions applicable to Form N-SAR filers are set forth in the EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 2 (August 2011). All of these provisions have been incorporated by reference into the Code of Federal Regulations, which action was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. You must comply with these requirements in order for documents to be timely received and accepted. You can obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1543, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Electronic copies are available on the Commission's website. The address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. You can also inspect the document at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202–741–6030, or go to: http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

March 04, 2014

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71653 / March 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15772

In the Matter of **WORLDWIDE CAPITAL, INC., and JEFFREY W. LYNN,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 against Worldwide Capital, Inc. ("Worldwide") and Jeffrey W. Lynn ("Lynn") (collectively, "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 it and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

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

Summary

1. These proceedings arise out of violations of Rule 105 of Regulation M of the Exchange Act by Lynn, operating through his alter ego, Worldwide. Rule 105 prohibits buying any equity security made available through a covered public offering from an underwriter or broker or dealer participating in the offering after having sold short the same security during the restricted period as defined therein.

2. On 60 occasions, from October 31, 2007 through February 23, 2012, Worldwide bought offered shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the restricted period. These violations collectively resulted in profits to Lynn and Worldwide of $4,212,797.

Respondents

3. Worldwide is a Delaware corporation with its principal office in Nassau County, New York. Worldwide is a proprietary trading firm that Lynn formed in 1993 for the purpose of investing and trading his own capital. Worldwide has never been registered with the Commission in any capacity.

4. Lynn, age 55, is the sole owner and president of Worldwide. From 1984 until 1987, Lynn was a registered representative of Merrill Lynch, Pierce, Fenner & Smith Inc., where he traded fixed income securities. Lynn resides in Boca Raton, Florida.

5. Lynn at all relevant times considered Worldwide to be nothing more than the formal name given to the deposit of his capital at his clearing firm. Lynn's and Worldwide's activities were intertwined, moreover, and their assets were commingled. Lynn routinely used Worldwide's back office staff to pay his personal expenses, for example, and those payments were made directly from Worldwide's bank account, with no distinction or segregation being made between personal and business expenses. Lynn exercised complete dominion and control over Worldwide, and he and the traders he engaged to trade his capital in Worldwide's accounts regarded the two as one and the same.

6. Most of Worldwide's trades were effected by individual traders engaged by Lynn. Under the terms of their arrangements, Lynn and his individual traders were to share equally in the profits and losses earned or sustained on the trades executed for Worldwide, which were funded entirely by Lynn. In addition to funding the trading, Lynn recruited the traders, hired and equipped the back office staff, and oversaw the trading and back office operations.

7. At all relevant times, Respondents' principal investment strategy was to obtain the maximum allocations possible for short-term trading in initial public offerings as well as follow-on and secondary offerings. Accordingly, the Worldwide traders purchased offering shares through numerous accounts at major broker-dealers. By contrast, most of their sales, including short sales, of equity securities, were executed through an account in Worldwide's name at one of several smaller broker-dealers that catered to small institutional customers and professional traders. All of

the Worldwide trades, regardless of the account in which the trade was executed, cleared and settled in a Worldwide master account at Worldwide's prime broker.

8. Lynn was in frequent contact with his traders, and was aware on at least a daily basis of the trades placed by his traders, and of Worldwide's securities positions. Lynn's awareness was based not only on his communications with individual traders and Worldwide's back office staff, but also his daily review of the individual traders' trading blotters, and Worldwide's trade management system.

Legal Framework

9. Rule 105 makes it unlawful for a person to purchase equity securities in a covered public offering from an underwriter, broker, or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Exchange Act Form 1-A or Form 1-E and ending with pricing.

10. Rule 105 applies irrespective of the short seller's intent in effecting the short sale. "The prohibition on purchasing offered securities . . . provides a bright line demarcation of prohibited conduct consistent with the prophylactic nature of Regulation M." Short Selling in Connection with a Public Offering, 72 Fed. Reg. at 45096. The Commission adopted Rule 105 in an effort to prevent manipulative short selling prior to a public offering and, therefore, "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity." Id. at 45094.

Respondents' Violations of Rule 105 of Regulation M

11. From October 31, 2007 to February 23, 2012, Lynn and his alter ego Worldwide violated Rule 105 in connection with 60 separate secondary and follow-on offerings, in each case by selling short shares of the issuers' stock during the restricted period, and then purchasing offering shares. As a result of these violations, Worldwide and Lynn received ill-gotten gains totaling approximately $8,425,595. After they paid the individual traders who had effected the short sales and received the offering shares their share of the profits, in accordance with the standard compensation arrangements, Lynn and Worldwide retained ill-gotten gains in the amount of $4,212,797.

12. The ill-gotten gains consisted of the following:

A. First, Worldwide and Lynn improperly profited from the difference between the proceeds from their improper restricted period short sales, and the amounts they paid on an equivalent number of shares received in the offerings of the same issuer's shares. These unlawful profits totaled approximately $3,787,385. After paying the individual traders, Worldwide and Lynn retained ill-gotten gains in the amount of $1,893,692.

B. Second, in those offerings where the number of shares they received in the offerings exceeded the number of shares they sold short during the restricted period ("overage"), Worldwide and Lynn and the individual traders improperly obtained an additional benefit in that they obtained the offering shares at a discount to the market price of the issuer's shares. Worldwide and Lynn and the individual traders received benefits from their violative conduct in the form of market discounts totaling $4,618,330, of which Lynn and Worldwide retained ill-gotten gains in the amount of $2,309,165.

C. Third, Worldwide and Lynn and the individual traders improperly benefitted in certain offerings where the offering price exceeded the price at which they had sold the stock short during the restricted period. Because they purchased their offering shares at a discount to the market price, they avoided losses in connection with these offerings in an amount that totaled $19,880, of which Worldwide's and Lynn's share totaled $9,940.

13. For example, on December 15, 2009, Worldwide sold short 4,118,300 shares of Citigroup, Inc. common stock at an average price of $3.6020. After the close of the market on December 16, 2009, a secondary offering of Citigroup common stock was priced at $3.1500. Worldwide purchased 44,399,201 shares in the offering. The difference between Worldwide's proceeds from the restricted period short sales of Citigroup shares and amount it paid for the equivalent number of shares purchased in the offering was $1,861,472. Worldwide obtained an additional improper benefit of $1,406,609 by purchasing the remaining 40,280,901 offering shares at a discount to the market price of $3.1849.

14. As another example, on September 23, 2010, Worldwide sold short 1,373,400 shares of Petroleo Brasileiro common stock, at an average price of $34.2057. Later that day, after the close of the market, a follow-on offering of Petroleo Brasilia common stock was priced at $34.490. Worldwide purchased a total of 20,025 shares in the offering. Although the offering price exceeded the price at which it had sold short the stock during the restricted period, Worldwide received an improper benefit in the amount of $18,041 by obtaining a number of shares equal to the number it had sold short at a discount from the market price, which was $35.3909.

15. The 60 offerings in which Worldwide and Lynn violated Rule 105 are listed on Exhibit A to this Order.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondents Worldwide and Lynn cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Worldwide and Lynn shall together, on a joint and several basis, pay disgorgement of $4,212,797, prejudgment interest of $526,358, and a civil monetary penalty in the amount of $2,514,571 (for a total of $7,253,726) to the to the Securities and Exchange Commission, for transmission to the United States Treasury. Payment shall be made in the following installments: (i) $2,500,000 shall be paid within twenty-one (21) business days following the date on which this Order is entered; (ii) $1,000,000 shall be paid within ninety (90) days following the date on which this Order is entered; (iii) $1,000,000 shall be paid within one hundred and eighty (180) days following the date on which this Order is entered; and $ 2,753,726 shall be paid within three hundred and sixty (360) days following the date on which this Order is entered. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment 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]

(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 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 Worldwide and Lynn as Respondents in these proceedings, and the file number of these

2 The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, Respondents must make payments pursuant to options (2) or (3) above.

proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Regional Director, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Exhibit A

	ISSUER	PRICING DATE & TIME
1	Melco PBL Entertainment (Macau) LTD (MPEL)	10/31/2007 After Close
2	Enernoc, Inc. (ENOC)	11/13/2007 After Close
3	Seattle Genetics, Inc. (SGEN)	1/18/2008 Before Open
4	Genoptix, Inc. (GXDX)	2/28/2008 After Close
5	BGC Partners, Inc. (BGCP)	6/4/2008 After Close
6	Health Care REIT Inc. (HCN)	9/4/2008 After Close
7	Mitsubishi UFJ Financial Group Inc. (MTU)	12/8/2008 Before Open
8	Medical Properties Trust, Inc. (MPW)	1/8/2009 After Close
9	Newmont Mining Corp (NEM)	1/28/2009 After Close
10	ProLogis Share of Beneficial (PLD)	4/8/2009 Before Open
11	Dow Chemical Company (DOW)	5/6/2009 After Close
12	U.S. Airways Group, Inc. (LCC)	5/7/2009 After Close
13	Wells Fargo & Co. (WFC)	5/8/2009 Before Open
14	Ford Motor Company (F)	5/12/2009 After Close
15	State Street Corp. (STT)	5/18/2009 After Close
16	Regions Finanical Corporation (RF)	5/20/2009 After Close
17	Terex Corp. (TEX)	5/29/2009 Before Open
18	New M&I Corporation (MI)	6/11/2009 After Close
19	Duncan Energry Partners, LP (DEP)	6/15/2009 After Close
20	Hospitality Properties Trust (HPT)	6/18/2009 After Close
21	Prospect Capital Corporation (PSEC)	6/30/2009 After Close
22	VanceInfo Technologies Inc. (VIT)	7/9/2009 After Close
23	CapitalSource Inc. (CSE)	7/14/2009 After Close
24	Ocwen Finanical Corporation (OCN)	8/12/2009 After Close
25	Penn Virginia GP Holdings, L.P. (PVG)	9/10/2009 After Close
26	New M&I Corporation (MI)	10/21/2009 After Close
27	Citigroup, Inc. (C)	12/16/2009 After Close
28	STR Holdings Inc. (STRI)	4/15/2010 After Close
29	Strategic Hotels & Resorts, Inc. (BEE)	5/13/2010 After Close
30	Resource Capital Corp. (RSO)	5/19/2010 After Close
31	Wabash National Corporation (WNC)	5/24/2010 After Close
32	Cypress Sharpridge Investments (CYS)	6/24/2010 After Close
33	Genco Shipping & Trading Ltd. (GNK)	7/21/2010 After Close

	ISSUER	PRICING DATE & TIME
34	Government Properties Income (GOV)	8/5/2010 After Close
35	Petroleo Brasileiro (PBR)	9/23/2010 After Close
36	Noranda Aluminum Holding Corp. (NOR)	12/6/2010 After Close
37	IntraLinks Holding, Inc. (IL)	12/6/2010 After Close
38	Stillwater Mining Company (SWC)	12/7/2010 After Close
39	Verint Systems Inc. (VRNT)	1/10/2011 After Close
40	MarkWest Energy Partners LP (MWE)	1/11/2011 Before Open
41	American Capital Agency Corp. (AGNC)	1/13/2011 After Close
42	LDK Solar Co., Ltd. (LDK)	1/27/2011 Before Open
43	StoneMor Parnters LP (STON)	2/3/2011 After Close
44	Quality Distribution Inc. (QLTY)	2/3/2011 After Close
45	Molycorp, Inc. (MCP)	2/11/2011 After Close
46	Gartner Inc. (IT)	2/17/2011 After Close
47	YPF Sociedad Anonima (YPF)	3/22/2011 After Close
48	Newcastle Investment Corporation (NCT)	3/23/2011 After Close
49	Energy Transfer Partners, L.P. (ETP)	3/29/2011 Before Open
50	Cobalt International Energy Inc. (CIE)	4/11/2011 After Close
51	American International Group, Inc. (AIG)	5/24/2011 After Close
52	Arch Coal, Inc. (ACI)	6/2/2011 After Close
53	Diana Containerships Inc. (DCIX)	6/9/2011 After Close
54	Five Star Quality Care, Inc. (FVE)	6/15/2011 After Close
55	Excel Trust, Inc. (EXL)	6/23/2011 After Close
56	Aegerion Pharmaceuticals, Inc. (AEGR)	6/23/2011 After Close
57	Calumet Specialty Products Partners, LP (CLMT)	9/8/2011 After Close
58	Newcastle Investment Corporation (NCT)	9/21/2011 After Close
59	Linn Energy, LLC (LINE)	1/12/2012 After Close
60	Cobalt International Energy Inc. (CIE)	2/23/2012 After Close

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71653 / March 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15772

In the Matter of

WORLDWIDE CAPITAL, INC., and JEFFREY W. LYNN,

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 against Worldwide Capital, Inc. ("Worldwide") and Jeffrey W. Lynn ("Lynn") (collectively, "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 it and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

---

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

Summary

1. These proceedings arise out of violations of Rule 105 of Regulation M of the Exchange Act by Lynn, operating through his alter ego, Worldwide. Rule 105 prohibits buying any equity security made available through a covered public offering from an underwriter or broker or dealer participating in the offering after having sold short the same security during the restricted period as defined therein.

2. On 60 occasions, from October 31, 2007 through February 23, 2012, Worldwide bought offered shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the restricted period. These violations collectively resulted in profits to Lynn and Worldwide of $4,212,797.

Respondents

3. Worldwide is a Delaware corporation with its principal office in Nassau County, New York. Worldwide is a proprietary trading firm that Lynn formed in 1993 for the purpose of investing and trading his own capital. Worldwide has never been registered with the Commission in any capacity.

4. Lynn, age 55, is the sole owner and president of Worldwide. From 1984 until 1987, Lynn was a registered representative of Merrill Lynch, Pierce, Fenner & Smith Inc., where he traded fixed income securities. Lynn resides in Boca Raton, Florida.

5. Lynn at all relevant times considered Worldwide to be nothing more than the formal name given to the deposit of his capital at his clearing firm. Lynn's and Worldwide's activities were intertwined, moreover, and their assets were commingled. Lynn routinely used Worldwide's back office staff to pay his personal expenses, for example, and those payments were made directly from Worldwide's bank account, with no distinction or segregation being made between personal and business expenses. Lynn exercised complete dominion and control over Worldwide, and he and the traders he engaged to trade his capital in Worldwide's accounts regarded the two as one and the same.

6. Most of Worldwide's trades were effected by individual traders engaged by Lynn. Under the terms of their arrangements, Lynn and his individual traders were to share equally in the profits and losses earned or sustained on the trades executed for Worldwide, which were funded entirely by Lynn. In addition to funding the trading, Lynn recruited the traders, hired and equipped the back office staff, and oversaw the trading and back office operations.

7. At all relevant times, Respondents' principal investment strategy was to obtain the maximum allocations possible for short-term trading in initial public offerings as well as follow-on and secondary offerings. Accordingly, the Worldwide traders purchased offering shares through numerous accounts at major broker-dealers. By contrast, most of their sales, including short sales, of equity securities, were executed through an account in Worldwide's name at one of several smaller broker-dealers that catered to small institutional customers and professional traders. All of

the Worldwide trades, regardless of the account in which the trade was executed, cleared and settled in a Worldwide master account at Worldwide's prime broker.

8. Lynn was in frequent contact with his traders, and was aware on at least a daily basis of the trades placed by his traders, and of Worldwide's securities positions. Lynn's awareness was based not only on his communications with individual traders and Worldwide's back office staff, but also his daily review of the individual traders' trading blotters, and Worldwide's trade management system.

Legal Framework

9. Rule 105 makes it unlawful for a person to purchase equity securities in a covered public offering from an underwriter, broker, or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Exchange Act Form 1-A or Form 1-E and ending with pricing.

10. Rule 105 applies irrespective of the short seller's intent in effecting the short sale. "The prohibition on purchasing offered securities . . . provides a bright line demarcation of prohibited conduct consistent with the prophylactic nature of Regulation M." Short Selling in Connection with a Public Offering, 72 Fed. Reg. at 45096. The Commission adopted Rule 105 in an effort to prevent manipulative short selling prior to a public offering and, therefore, "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity." Id. at 45094.

Respondents' Violations of Rule 105 of Regulation M

11. From October 31, 2007 to February 23, 2012, Lynn and his alter ego Worldwide violated Rule 105 in connection with 60 separate secondary and follow-on offerings, in each case by selling short shares of the issuers' stock during the restricted period, and then purchasing offering shares. As a result of these violations, Worldwide and Lynn received ill-gotten gains totaling approximately $8,425,595. After they paid the individual traders who had effected the short sales and received the offering shares their share of the profits, in accordance with the standard compensation arrangements, Lynn and Worldwide retained ill-gotten gains in the amount of $4,212,797.

12. The ill-gotten gains consisted of the following:

A. First, Worldwide and Lynn improperly profited from the difference between the proceeds from their improper restricted period short sales, and the amounts they paid on an equivalent number of shares received in the offerings of the same issuer's shares. These unlawful profits totaled approximately $3,787,385. After paying the individual traders, Worldwide and Lynn retained ill-gotten gains in the amount of $1,893,692.

B. Second, in those offerings where the number of shares they received in the offerings exceeded the number of shares they sold short during the restricted period ("overage"), Worldwide and Lynn and the individual traders improperly obtained an additional benefit in that they obtained the offering shares at a discount to the market price of the issuer's shares. Worldwide and Lynn and the individual traders received benefits from their violative conduct in the form of market discounts totaling $4,618,330, of which Lynn and Worldwide retained ill-gotten gains in the amount of $2,309,165.

C. Third, Worldwide and Lynn and the individual traders improperly benefitted in certain offerings where the offering price exceeded the price at which they had sold the stock short during the restricted period. Because they purchased their offering shares at a discount to the market price, they avoided losses in connection with these offerings in an amount that totaled $19,880, of which Worldwide's and Lynn's share totaled $9,940.

13. For example, on December 15, 2009, Worldwide sold short 4,118,300 shares of Citigroup, Inc. common stock at an average price of $3.6020. After the close of the market on December 16, 2009, a secondary offering of Citigroup common stock was priced at $3.1500. Worldwide purchased 44,399,201 shares in the offering. The difference between Worldwide's proceeds from the restricted period short sales of Citigroup shares and amount it paid for the equivalent number of shares purchased in the offering was $1,861,472. Worldwide obtained an additional improper benefit of $1,406,609 by purchasing the remaining 40,280,901 offering shares at a discount to the market price of $3.1849.

14. As another example, on September 23, 2010, Worldwide sold short 1,373,400 shares of Petroleo Brasileiro common stock, at an average price of $34.2057. Later that day, after the close of the market, a follow-on offering of Petroleo Brasilia common stock was priced at $34.490. Worldwide purchased a total of 20,025 shares in the offering. Although the offering price exceeded the price at which it had sold short the stock during the restricted period, Worldwide received an improper benefit in the amount of $18,041 by obtaining a number of shares equal to the number it had sold short at a discount from the market price, which was $35.3909.

15. The 60 offerings in which Worldwide and Lynn violated Rule 105 are listed on Exhibit A to this Order.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondents Worldwide and Lynn cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Worldwide and Lynn shall together, on a joint and several basis, pay disgorgement of $4,212,797, prejudgment interest of $526,358, and a civil monetary penalty in the amount of $2,514,571 (for a total of $7,253,726) to the to the Securities and Exchange Commission, for transmission to the United States Treasury. Payment shall be made in the following installments: (i) $2,500,000 shall be paid within twenty-one (21) business days following the date on which this Order is entered; (ii) $1,000,000 shall be paid within ninety (90) days following the date on which this Order is entered; (iii) $1,000,000 shall be paid within one hundred and eighty (180) days following the date on which this Order is entered; and $ 2,753,726 shall be paid within three hundred and sixty (360) days following the date on which this Order is entered. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment 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]

(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 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 Worldwide and Lynn as Respondents in these proceedings, and the file number of these

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2 The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, Respondents must make payments pursuant to options (2) or (3) above.

proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Regional Director, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Exhibit A

	ISSUER	PRICING DATE & TIME
1	Melco PBL Entertainment (Macau) LTD (MPEL)	10/31/2007 After Close
2	Enernoc, Inc. (ENOC)	11/13/2007 After Close
3	Seattle Genetics, Inc. (SGEN)	1/18/2008 Before Open
4	Genoptix, Inc. (GXDX)	2/28/2008 After Close
5	BGC Partners, Inc. (BGCP)	6/4/2008 After Close
6	Health Care REIT Inc. (HCN)	9/4/2008 After Close
7	Mitsubishi UFJ Financial Group Inc. (MTU)	12/8/2008 Before Open
8	Medical Properties Trust, Inc. (MPW)	1/8/2009 After Close
9	Newmont Mining Corp (NEM)	1/28/2009 After Close
10	ProLogis Share of Beneficial (PLD)	4/8/2009 Before Open
11	Dow Chemical Company (DOW)	5/6/2009 After Close
12	U.S. Airways Group, Inc. (LCC)	5/7/2009 After Close
13	Wells Fargo & Co. (WFC)	5/8/2009 Before Open
14	Ford Motor Company (F)	5/12/2009 After Close
15	State Street Corp. (STT)	5/18/2009 After Close
16	Regions Finanical Corporation (RF)	5/20/2009 After Close
17	Terex Corp. (TEX)	5/29/2009 Before Open
18	New M&I Corporation (MI)	6/11/2009 After Close
19	Duncan Energry Partners, LP (DEP)	6/15/2009 After Close
20	Hospitality Properties Trust (HPT)	6/18/2009 After Close
21	Prospect Capital Corporation (PSEC)	6/30/2009 After Close
22	VanceInfo Technologies Inc. (VIT)	7/9/2009 After Close
23	CapitalSource Inc. (CSE)	7/14/2009 After Close
24	Ocwen Finanical Corporation (OCN)	8/12/2009 After Close
25	Penn Virginia GP Holdings, L.P. (PVG)	9/10/2009 After Close
26	New M&I Corporation (MI)	10/21/2009 After Close
27	Citigroup, Inc. (C)	12/16/2009 After Close
28	STR Holdings Inc. (STRI)	4/15/2010 After Close
29	Strategic Hotels & Resorts, Inc. (BEE)	5/13/2010 After Close
30	Resource Capital Corp. (RSO)	5/19/2010 After Close
31	Wabash National Corporation (WNC)	5/24/2010 After Close
32	Cypress Sharpridge Investments (CYS)	6/24/2010 After Close
33	Genco Shipping & Trading Ltd. (GNK)	7/21/2010 After Close

	ISSUER	PRICING DATE & TIME
34	Government Properties Income (GOV)	8/5/2010 After Close
35	Petroleo Brasileiro (PBR)	9/23/2010 After Close
36	Noranda Aluminum Holding Corp. (NOR)	12/6/2010 After Close
37	IntraLinks Holding, Inc. (IL)	12/6/2010 After Close
38	Stillwater Mining Company (SWC)	12/7/2010 After Close
39	Verint Systems Inc. (VRNT)	1/10/2011 After Close
40	MarkWest Energy Partners LP (MWE)	1/11/2011 Before Open
41	American Capital Agency Corp. (AGNC)	1/13/2011 After Close
42	LDK Solar Co., Ltd. (LDK)	1/27/2011 Before Open
43	StoneMor Parnters LP (STON)	2/3/2011 After Close
44	Quality Distribution Inc. (QLTY)	2/3/2011 After Close
45	Molycorp, Inc. (MCP)	2/11/2011 After Close
46	Gartner Inc. (IT)	2/17/2011 After Close
47	YPF Sociedad Anonima (YPF)	3/22/2011 After Close
48	Newcastle Investment Corporation (NCT)	3/23/2011 After Close
49	Energy Transfer Partners, L.P. (ETP)	3/29/2011 Before Open
50	Cobalt International Energy Inc. (CIE)	4/11/2011 After Close
51	American International Group, Inc. (AIG)	5/24/2011 After Close
52	Arch Coal, Inc. (ACI)	6/2/2011 After Close
53	Diana Containerships Inc. (DCIX)	6/9/2011 After Close
54	Five Star Quality Care, Inc. (FVE)	6/15/2011 After Close
55	Excel Trust, Inc. (EXL)	6/23/2011 After Close
56	Aegerion Pharmaceuticals, Inc. (AEGR)	6/23/2011 After Close
57	Calumet Specialty Products Partners, LP (CLMT)	9/8/2011 After Close
58	Newcastle Investment Corporation (NCT)	9/21/2011 After Close
59	Linn Energy, LLC (LINE)	1/12/2012 After Close
60	Cobalt International Energy Inc. (CIE)	2/23/2012 After Close

<u>Service List</u>

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Cease-and-Desist Proceedings Pursuant to 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), on the Respondents and their legal agents.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray
Chief Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2557

Leslie Kazon, Esq.
New York Regional Office
Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281

Worldwide Capital, Inc.
c/o Nicole DeBello, Esq.
Lowenstein Sandler LLP
1251 Avenue of the Americas
New York, NY 10020

Jeffrey W. Lynn
c/o Nicole DeBello, Esq.
Lowenstein Sandler LLP
1251 Avenue of the Americas
New York, NY 10020

Nicole DeBello, Esq.
Lowenstein Sandler LLP
1251 Avenue of the Americas
New York, NY 10020
(Counsel for Worldwide Capital, Inc. & Jeffrey W. Lynn)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 5, 2014

IN THE MATTER OF AVENTURA EQUITIES, 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 Aventura Equities, Inc. ("Aventura") because of questions concerning the adequacy and accuracy of publicly available information about Aventura, including, among other things, its financial condition, the control of the company, its business operations, and trading in its securities. Aventura is a Florida corporation based in Georgetown, South Carolina, and is traded under the symbol "AVNE."

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 March 5, 2014, through 11:59 p.m. EDT, on March 18, 2014.

By the Commission.

Elizabeth M. Murphy
Secretary

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

Chair White
Not participating
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71654 / March 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15507

In the Matter of

JPMorgan Chase & Co.,

Respondent.

ORDER ESTABLISHING A FAIR FUND

On September 19, 2013, the Commission issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order") against JPMorgan Chase & Co. ("JPMorgan").[1] The Order required JPMorgan to pay a civil money penalty in the amount of $200,000,000 to the Commission and ordered that such penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Sarbanes-Oxley Act").

The Division of Enforcement ("Division") now requests that a Fair Fund be established pursuant to Section 308(a) of the Sarbanes-Oxley Act for the $200,000,000 civil money penalty collected from JPMorgan for distribution to injured investors.

Accordingly, IT IS HEREBY ORDERED that, pursuant to Section 308(a) of the Sarbanes-Oxley Act, a Fair Fund is established for JPMorgan's civil money penalty payment.

By the Commission.

Lynn M. Powalski
Lynn M. Powalski
Deputy Secretary

[1] *See* Exchange Act Rel. 70458 (Sep. 19, 2013).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71649; File No. 4-631)

March 5, 2014

Joint Industry Plan; Notice of Filing of the Seventh Amendment to the National Market System Plan to Address Extraordinary Market Volatility by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The Nasdaq Stock Market LLC, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc.

Pursuant to Section 11A of the Securities Exchange Act of 1934 ("Act")[1] and Rule 608 thereunder[2], notice is hereby given that, on February 24, 2014, NYSE Euronext, on behalf of New York Stock Exchange LLC ("NYSE"), NYSE MKT LLC ("NYSE MKT"), and NYSE Arca, Inc. ("NYSE Arca"), and the following parties to the National Market System Plan: BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC, and National Stock Exchange, Inc. (collectively with NYSE, NYSE MKT, and NYSE Arca, the "Participants"), filed with the Securities and Exchange Commission (the "Commission") a proposal to amend the Plan to Address Extraordinary Market Volatility ("Plan").[3] The proposal represents the seventh amendment to the Plan ("Seventh Amendment"), and reflects changes unanimously approved by the Participants. The Seventh Amendment to the Plan proposes to amend the Plan to extend the pilot period of the Plan to February 20, 2015 and makes changes to Appendix B of the Plan regarding when the Participants are required to submit

1 15 U.S.C. 78k-1.

2 17 CFR 242.608.

3 See Letter from Martha Redding, Chief Counsel, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated February 21, 2014 ("Transmittal Letter").

specified summary data to the Commission. A copy of the Plan, as proposed to be amended, is attached as Exhibit A hereto. The Commission is publishing this notice to solicit comments from interested persons on the Seventh Amendment to the Plan.

I. Rule 608(a) of Regulation NMS

A. Purpose of the Plan

The Participants filed the Plan in order to create a market-wide limit up-limit down mechanism that is intended to address extraordinary market volatility in "NMS Stocks," as defined in Rule 600(b)(47) of Regulation NMS under the Act.[4] The Plan sets forth procedures that provide for market-wide limit up-limit down requirements that would be designed to prevent trades in individual NMS Stocks from occurring outside of the specified Price Bands.[5] These limit up-limit down requirements would be coupled with Trading Pauses, as defined in Section I(Y) of the Plan, to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity).

As set forth in Section V of the Plan, the price bands would consist of a Lower Price Band and an Upper Price Band for each NMS Stock.[6] The price bands would be calculated by the Securities Information Processors ("SIPs" or "Processors") responsible for consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS under the Act.[7] Those price bands would be based on a Reference Price[8] for each NMS Stock that equals the arithmetic mean price of Eligible Reported Transactions for the NMS Stock over the

4 17 CFR 242.600(b)(47). See also Section I(H) of the Plan.

5 See Section V of the Plan.

6 Capitalized terms used herein but not otherwise defined shall have the meaning ascribed to such terms in the Plan. See Exhibit A, infra.

7 17 CFR 242.603(b). The Plan refers to this entity as the Processor.

8 See Section I(T) of the Plan.

immediately preceding five-minute period. The price bands for an NMS Stock would be calculated by applying the Percentage Parameter for such NMS Stock to the Reference Price, with the Lower Price Band being a Percentage Parameter[9] below the Reference Price, and the Upper Price Band being a Percentage Parameter above the Reference Price. Between 9:30 a.m. and 9:45 a.m. ET and 3:35 p.m. and 4:00 p.m. ET, the price bands would be calculated by applying double the Percentage Parameters.

The Processors would also calculate a Pro-Forma Reference Price for each NMS Stock on a continuous basis during Regular Trading Hours. If a Pro-Forma Reference Price did not move by one percent or more from the Reference Price in effect, no new price bands would be disseminated, and the current Reference Price would remain the effective Reference Price. If the Pro-Forma Reference Price moved by one percent or more from the Reference Price in effect, the Pro-Forma Reference Price would become the Reference Price, and the Processors would disseminate new price bands based on the new Reference Price. Each new Reference Price would remain in effect for at least 30 seconds.

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9 As initially proposed by the Participants, the Percentage Parameters for Tier 1 NMS Stocks (i.e., stocks in the S&P 500 Index or Russell 1000 Index and certain ETPs) with a Reference Price of $1.00 or more would be five percent and less than $1.00 would be the lesser of (a) $0.15 or (b) 75 percent. The Percentage Parameters for Tier 2 NMS Stocks (i.e., all NMS Stocks other than those in Tier 1) with a Reference Price of $1.00 or more would be 10 percent and less than $1.00 would be the lesser of (a) $0.15 or (b) 75 percent. The Percentage Parameters for a Tier 2 NMS Stock that is a leveraged ETP would be the applicable Percentage Parameter set forth above multiplied by the leverage ratio of such product. On May 24, 2012, the Participants amended the Plan to create a 20% price band for Tier 1 and Tier 2 stocks with a Reference Price of $0.75 or more and up to and including $3.00. The Percentage Parameter for stocks with a Reference Price below $0.75 would be the lesser of (a) $0.15 or (b) 75 percent. See Letter from Janet M. McGinness, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated May 24, 2012 ("First Amendment").

When one side of the market for an individual security is outside the applicable price band, the Processors would be required to disseminate such National Best Bid[10] or National Best Offer[11] with an appropriate flag identifying it as non-executable. When the other side of the market reaches the applicable price band, the market for an individual security would enter a Limit State,[12] and the Processors would be required to disseminate such National Best Offer or National Best Bid with an appropriate flag identifying it as a Limit State Quotation.[13] All trading would immediately enter a Limit State if the National Best Offer equals the Lower Limit Band and does not cross the National Best Bid, or the National Best Bid equals the Upper Limit Band and does not cross the National Best Offer. Trading for an NMS Stock would exit a Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market did not exit a Limit State within 15 seconds, then the Primary Listing Exchange would declare a five-minute trading pause, which would be applicable to all markets trading the security.

These limit up-limit down requirements would be coupled with trading pauses[14] to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity). As set forth in more detail in the Plan, all trading centers[15] in NMS Stocks,

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10 17 CFR 242.600(b)(42). See also Section I(G) of the Plan.

11 Id.

12 A stock enters the Limit State if the National Best Offer equals the Lower Price Band and does not cross the National Best Bid, or the National Best Bid equals the Upper Price Band and does not cross the National Best Offer. See Section VI(B) of the Plan.

13 See Section I(D) of the Plan.

14 The primary listing market would declare a trading pause in an NMS Stock; upon notification by the primary listing market, the Processor would disseminate this information to the public. No trades in that NMS Stock could occur during the trading pause, but all bids and offers may be displayed. See Section VII(A) of the Plan.

15 As defined in Section I(X) of the Plan, a trading center shall have the meaning provided

including both those operated by Participants and those operated by members of Participants, would be required to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the limit up-limit down and trading pause requirements specified in the Plan.

Under the Plan, all trading centers would be required to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for an NMS Stock. The Processors would disseminate an offer below the Lower Price Band or bid above the Upper Price Band that nevertheless inadvertently may be submitted despite such reasonable policies and procedures, but with an appropriate flag identifying it as non-executable; such bid or offer would not be included in National Best Bid or National Best Offer calculations. In addition, all trading centers would be required to develop, maintain, and enforce policies and procedures reasonably designed to prevent trades at prices outside the price bands, with the exception of single-priced opening, reopening, and closing transactions on the Primary Listing Exchange.

As stated by the Participants in the Plan, the limit up-limit down mechanism is intended to reduce the negative impacts of sudden, unanticipated price movements in NMS Stocks,[16] thereby protecting investors and promoting a fair and orderly market.[17] In particular, the Plan is designed to address the type of sudden price movements that the market experienced on the afternoon of May 6, 2010.[18]

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in Rule 600(b)(78) of Regulation NMS under the Act.

16 17 CFR 242.600(b)(47).

17 See Transmittal Letter, supra note 3.

18 The limit up-limit down mechanism set forth in the Plan would replace the existing single-stock circuit breaker pilot. See e.g., Securities Exchange Act Release Nos. 62251 (June 10, 2010), 75 FR 34183 (June 16, 2010) (SR-FINRA-2010-025); 62883 (September

The following summarizes the Seventh Amendment to the Plan and the rationale behind those changes:

Proposed Amendment

The Plan was initially approved for a one-year pilot, which began on April 8, 2013. Accordingly, the pilot period is currently scheduled to end on April 8, 2014. As initially contemplated, the Plan would have been fully implemented across all NMS Stocks within six months of initial Plan operations, which meant there would have been full implementation of the Plan for six months before the end of the pilot period. However, pursuant to the Fourth Amendment to the Plan, the Participants amended Section VIII.B of the Plan, which modified the implementation schedule of Phase II of the Plan to extend the time period when the Plan would fully apply to all NMS Stocks. Accordingly, the Plan was not implemented across all NMS Stocks until December 8, 2013.

In addition, pursuant to the Sixth Amendment to the Plan, which further modified the implementation schedule of Phase II of the Plan, the date for full implementation of the Plan was moved to February 24, 2014. Prior to February 24, 2014, the Plan will have only been in effect from 9:30 a.m. Eastern to 3:45 p.m. Eastern, and will not include the fifteen minutes of trading preceding the close. Accordingly, there will be less than two months of full operation of the Plan before the end of the pilot period.

The Participants do not believe that this short period of full implementation of the Plan will provide sufficient time for either the Participants or the Commission to assess the impact of the Plan and determine whether the Plan should be modified prior to approval on a permanent basis. Rather, the Participants believe that the pilot period should be extended to provide

10, 2010), 75 FR 56608 (September 16, 2010) (SR-FINRA-2010-033).

sufficient time to review data based on full implementation of the Plan and if necessary, propose modifications in connection with seeking to approve the Plan on a permanent basis.

Accordingly, the Participants propose to amend Section VIII.C of the Plan to extend the current one-year pilot, which is scheduled to end on April 8, 2014, to have the pilot set to end on February 20, 2015. The proposed new end date for the pilot would provide for a year of full implementation of the Plan before the pilot period ends. The Participants believe that this proposed pilot extension is appropriate in the public interest, for the protection of investors and the maintenance of a fair and orderly market because it provides additional time to assess the operation of the Plan. The Participants further believe that the proposed amendment is consistent with the approval order for the Plan, in which the Commission stated that having a pilot period would allow "the public, the Participants, and the Commission to assess the operation of the Plan and whether the Plan should be modified prior to approval on a permanent basis."[19]

Because the goal of the pilot period is to provide an opportunity to assess whether the Plan should be modified prior to approval on a permanent basis, the Participants further propose to amend Section III to Appendix B of the Plan to move the time by which the Participants would be required to submit assessments of the Plan operations. Under the current Plan, the time to provide such assessments is scheduled for two months prior to the end of the pilot period. As originally contemplated, such reports would therefore have been based on approximately four months' worth of data from full implementation of the Plan.

The Participants continue to believe that they would be able to assess the Plan based on a similar data set. The Participants further believe that providing the Commission with such assessments earlier than two months before the end of the pilot period would provide additional

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19 See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498, 33508 (June 6, 2012).

time for the Commission to review such assessments and better inform any determination of whether the Plan should be modified prior to approval on a permanent basis. The Participants further believe that revising the time when such assessments would be provided to the Commission would provide the Participants with sufficient time to conduct such assessments. Accordingly, the Participants propose to amend Section III of Appendix B of the Plan to delete the requirement that the assessments be provided at least two months prior to the end of the pilot period, and replace it with a specified date when such assessments shall be provided. The Participants propose that the assessments be provided by September 30, 2014. The Participants believe that this proposed new date for submission of assessments is appropriate in the public interest, for the protection of investors, and the maintenance of a fair and orderly market because it will serve the goals of having sufficient amount of data to review, consistent with the current Plan, providing time for the Participants to complete their assessments of the data, and providing time for the Commission to review such assessments with enough time remaining within the proposed new pilot period to determine whether to modify the Plan prior to approval on a permanent basis.

The Participants note that the amended version of the Plan also includes the revised Appendix A – Schedule 1, which was updated for trading beginning January 3, 2014. As set forth in Appendix A – Percentage Parameters, the Primary Listing Exchange update Schedule 1 to Appendix A semi-annually based on the fiscal year and such updates do not require a Plan amendment.

B. Governing or Constituent Documents

The governing documents of the Processor, as defined in Section I(P) of the Plan, will not be affected by the Plan, but once the Plan is implemented, the Processor's obligations will change, as set forth in detail in the Plan.

C. Implementation of Plan

The initial date of the Plan operations was April 8, 2013.

D. Development and Implementation Phases

The Plan will be implemented as a one-year pilot program in two Phases, consistent with Section VIII of the Plan: Phase I of Plan implementation began on April 8, 2013 and was completed on May 3, 2013. Implementation of Phase II of the Plan began on August 5, 2013 and is scheduled to be completed on February 24, 2014. Pursuant to this proposed amendment, the Participants propose to extend the pilot period so that it is set to end February 20, 2015.

E. Analysis of Impact on Competition

The Participants state that the proposed Plan does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Participants do not believe that the proposed Plan introduces terms that are unreasonably discriminatory for the purposes of Section 11A(c)(1)(D) of the Exchange Act.

F. Written Understanding or Agreements relating to Interpretation of, or Participation in, Plan

The Participants state that they have no written understandings or agreements relating to interpretation of the Plan. Section II(C) of the Plan sets forth how any entity registered as a national securities exchange or national securities association may become a Participant.

G. Approval of Amendment of the Plan

Each of the Plan's Participants has executed a written amended Plan.

H. Terms and Conditions of Access

Section II(C) of the Plan provides that any entity registered as a national securities exchange or national securities association under the Act may become a Participant by: (1) becoming a participant in the applicable Market Data Plans, as defined in Section I(F) of the Plan; (2) executing a copy of the Plan, as then in effect; (3) providing each then-current Participant with a copy of such executed Plan; and (4) effecting an amendment to the Plan as specified in Section III(B) of the Plan.

I. Method of Determination and Imposition, and Amount of, Fees and Charges

Not applicable.

J. Method and Frequency of Processor Evaluation

Not applicable.

K. Dispute Resolution

The Plan does not include specific provisions regarding resolution of disputes between or among Participants. Section III(C) of the Plan provides for each Participant to designate an individual to represent the Participant as a member of an Operating Committee.[20] No later than the initial date of the Plan, the Operating Committee would be required to designate one member of the Operating Committee to act as the Chair of the Operating Committee. The Operating Committee shall monitor the procedures established pursuant to the Plan and advise the Participants with respect to any deficiencies, problems, or recommendations as the Operating Committee may deem appropriate. Any recommendation for an amendment to the Plan from the Operating Committee that receives an affirmative vote of at least two-thirds of the Participants, but is less than unanimous, shall be submitted to the Commission as a request for an amendment

[20] See Section I(J) of the Plan.

to the Plan initiated by the Commission under Rule 608 of Regulation NMS under the Act.[21]

II. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the Seventh Amendment to the Plan 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 4-631 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 4-631. 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 Seventh Amendment to the Plan that are filed with the Commission, and all written communications relating to the Seventh Amendment to the Plan between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between 10:00 a.m. and 3:00 p.m. Copies of

[21] 17 CFR 242.608.

the filing will also be available for inspection and copying at the Participants' principal offices. 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 4-631 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

EXHIBIT A

Proposed new language is italicized; proposed deletions are in [brackets].

PLAN TO ADDRESS EXTRAORDINARY MARKET VOLATILITY

SUBMITTED TO

THE SECURITIES AND EXCHANGE COMMISSION

PURSUANT TO RULE 608 OF REGULATION NMS

UNDER THE

SECURITIES EXCHANGE ACT OF 1934

<u>Table of Contents</u>

Section		Page
Preamble		1
I.	Definitions	2
II.	Parties	4
III.	Amendments to Plan	7
IV.	Trading Center Policies and Procedures	8
V.	Price Bands	9
VI.	Limit Up-Limit Down Requirements	11
VII.	Trading Pauses	13
VIII.	Implementation	15
IX.	Withdrawal from Plan	16
X.	Counterparts and Signatures	16
Appendix A – Percentage Parameters		1[8]9
Appendix A – Schedule 1		21
Appendix B – Data		34

Preamble

The Participants submit to the SEC this Plan establishing procedures to address extraordinary volatility in NMS Stocks. The procedures provide for market-wide limit up-limit down requirements that prevent trades in individual NMS Stocks from occurring outside of the specified Price Bands. These limit up-limit down requirements are coupled with Trading Pauses to accommodate more fundamental price moves. The Plan procedures are designed, among other things, to protect investors and promote fair and orderly markets. The Participants developed this Plan pursuant to Rule 608(a)(3) of Regulation NMS under the Exchange Act, which authorizes the Participants to act jointly in preparing, filing, and implementing national market system plans.

I. Definitions

(A) "Eligible Reported Transactions" shall have the meaning prescribed by the Operating Committee and shall generally mean transactions that are eligible to update the last sale price of an NMS Stock.

(B) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(C) "Limit State" shall have the meaning provided in Section VI of the Plan.

(D) "Limit State Quotation" shall have the meaning provided in Section VI of the Plan.

(E) "Lower Price Band" shall have the meaning provided in Section V of the Plan.

(F) "Market Data Plans" shall mean the effective national market system plans through which the Participants act jointly to disseminate consolidated information in compliance with Rule 603(b) of Regulation NMS under the Exchange Act.

(G) "National Best Bid" and "National Best Offer" shall have the meaning provided in Rule 600(b)(42) of Regulation NMS under the Exchange Act.

(H) "NMS Stock" shall have the meaning provided in Rule 600(b)(47) of Regulation NMS under the Exchange Act.

(I) "Opening Price" shall mean the price of a transaction that opens trading on the Primary Listing Exchange, or, if the Primary Listing Exchange opens with quotations, the midpoint of those quotations.

(J) "Operating Committee" shall have the meaning provided in Section III(C) of the Plan.

(K) "Participant" means a party to the Plan.

(L) "Plan" means the plan set forth in this instrument, as amended from time to time in accordance with its provisions.

(M) "Percentage Parameter" shall mean the percentages for each tier of NMS Stocks set forth in Appendix A of the Plan.

(N) "Price Bands" shall have the meaning provided in Section V of the Plan.

(O) "Primary Listing Exchange" shall mean the Participant on which an NMS Stock is listed. If an NMS Stock is listed on more than one Participant, the Participant on which the NMS Stock has been listed the longest shall be the Primary Listing Exchange.

(P) "Processor" shall mean the single plan processor responsible for the consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS under the Exchange Act.

(Q) "Pro-Forma Reference Price" shall have the meaning provided in Section V(A)(2) of the Plan.

(R) "Regular Trading Hours" shall have the meaning provided in Rule 600(b)(64) of Regulation NMS under the Exchange Act. For purposes of the Plan, Regular Trading Hours can end earlier than 4:00 p.m. ET in the case of an early scheduled close.

(S) "Regulatory Halt" shall have the meaning specified in the Market Data Plans.

(T) "Reference Price" shall have the meaning provided in Section V of the Plan.

(U) "Reopening Price" shall mean the price of a transaction that reopens trading on the Primary Listing Exchange following a Trading Pause or a Regulatory Halt, or, if the Primary Listing Exchange reopens with quotations, the midpoint of those quotations.

(V) "SEC" shall mean the United States Securities and Exchange Commission.

(W) "Straddle State" shall have the meaning provided in Section VII(A)(2) of the Plan.

(X) "Trading center" shall have the meaning provided in Rule 600(b)(78) of Regulation NMS under the Exchange Act.

(Y) "Trading Pause" shall have the meaning provided in Section VII of the Plan.

(Z) "Upper Price Band" shall have the meaning provided in Section V of the Plan.

II. Parties

(A) <u>List of Parties</u>

The parties to the Plan are as follows:

(1) BATS Exchange, Inc.
8050 Marshall Drive
Lenexa, Kansas 66214

(2) BATS Y-Exchange, Inc.
8050 Marshall Drive
Lenexa, Kansas 66214

(3) Chicago Board Options Exchange, Incorporated
400 South LaSalle Street
Chicago, Illinois 60605

(4) Chicago Stock Exchange, Inc.
440 South LaSalle Street
Chicago, Illinois 60605

(5) EDGA Exchange, Inc.
545 Washington Boulevard
Sixth Floor
Jersey City, NJ 07310

(6) EDGX Exchange, Inc.
545 Washington Boulevard
Sixth Floor
Jersey City, NJ 07310

(7) Financial Industry Regulatory Authority, Inc.
1735 K Street, NW

Washington, DC 20006

(8) NASDAQ OMX BX, Inc.
One Liberty Plaza
New York, New York 10006

(9) NASDAQ OMX PHLX LLC
1900 Market Street
Philadelphia, Pennsylvania 19103

(10) The Nasdaq Stock Market LLC
1 Liberty Plaza
165 Broadway
New York, NY 10006

(11) National Stock Exchange, Inc.
101 Hudson, Suite 1200
Jersey City, NJ 07302

(12) New York Stock Exchange LLC
11 Wall Street
New York, New York 10005

(13) NYSE MKT LLC
20 Broad Street
New York, New York 10005

(14) NYSE Arca, Inc.
100 South Wacker Drive
Suite 1800
Chicago, IL 60606

(B) <u>Compliance Undertaking</u>

By subscribing to and submitting the Plan for approval by the SEC, each Participant agrees to comply with and to enforce compliance, as required by Rule 608(c) of Regulation NMS under the Exchange Act, by its members with the provisions of the Plan. To this end, each Participant shall adopt a rule requiring compliance by its members with the provisions of the Plan, and each Participant shall take such actions as are necessary and appropriate as a participant of the Market Data Plans to cause and enable the Processor for each NMS Stock to fulfill the functions set forth in this Plan.

(C) New Participants

The Participants agree that any entity registered as a national securities exchange or national securities association under the Exchange Act may become a Participant by: (1) becoming a participant in the applicable Market Data Plans; (2) executing a copy of the Plan, as then in effect; (3) providing each then-current Participant with a copy of such executed Plan; and (4) effecting an amendment to the Plan as specified in Section III(B) of the Plan.

(D) Advisory Committee

(1) Formation. Notwithstanding other provisions of this Plan, an Advisory Committee to the Plan shall be formed and shall function in accordance with the provisions set forth in this section.

(2) Composition. Members of the Advisory Committee shall be selected for two-year terms as follows:

(A) Advisory Committee Selections. By affirmative vote of a majority of the Participants, the Participants shall select at least one representatives from each of the following categories to be members of the Advisory Committee: (1) a broker-dealer with a substantial retail investor customer base; (2) a broker-dealer with a substantial institutional investor customer base; (3) an alternative trading system; (4) a broker-dealer that primarily engages in trading for its own account; and (5) an investor.

(3) Function. Members of the Advisory Committee shall have the right to submit their views to the Operating Committee on Plan matters, prior to a decision by the Operating

Committee on such matters. Such matters shall include, but not be limited to, proposed material amendments to the Plan.

(4) Meetings and Information. Members of the Advisory Committee shall have the right to attend meetings of the Operating Committee and to receive any information concerning Plan matters; provided, however, that the Operating Committee may meet in executive session if, by affirmative vote of a majority of the Participants, the Operating Committee determines that an item of Plan business requires confidential treatment.

III. Amendments to Plan

(A) General Amendments

Except with respect to the addition of new Participants to the Plan, any proposed change in, addition to, or deletion from the Plan shall be effected by means of a written amendment to the Plan that: (1) sets forth the change, addition, or deletion; (2) is executed on behalf of each Participant; and, (3) is approved by the SEC pursuant to Rule 608 of Regulation NMS under the Exchange Act, or otherwise becomes effective under Rule 608 of Regulation NMS under the Exchange Act.

(B) New Participants

With respect to new Participants, an amendment to the Plan may be effected by the new national securities exchange or national securities association executing a copy of the Plan, as then in effect (with the only changes being the addition of the new Participant's name in Section II(A) of the Plan) and submitting such executed Plan to the SEC for approval. The amendment shall be effective when it is approved by the SEC in accordance with Rule 608 of Regulation NMS under the Exchange Act or otherwise becomes effective pursuant to Rule 608 of Regulation NMS under the Exchange Act.

(C) Operating Committee

(1) Each Participant shall select from its staff one individual to represent the Participant as a member of an Operating Committee, together with a substitute for such individual. The substitute may participate in deliberations of the Operating Committee and shall be considered a voting member thereof only in the absence of the primary representative. Each Participant shall have one vote on all matters considered by the Operating Committee. No later than the initial date of Plan operations, the Operating Committee shall designate one member of the Operating Committee to act as the Chair of the Operating Committee.

(2) The Operating Committee shall monitor the procedures established pursuant to this Plan and advise the Participants with respect to any deficiencies, problems, or recommendations as the Operating Committee may deem appropriate. The Operating Committee shall establish specifications and procedures for the implementation and operation of the Plan that are consistent with the provisions of this Plan and the Appendixes thereto. With respect to matters in this paragraph, Operating Committee decisions shall be approved by a simple majority vote.

(3) Any recommendation for an amendment to the Plan from the Operating Committee that receives an affirmative vote of at least two-thirds of the Participants, but is less than unanimous, shall be submitted to the SEC as a request for an amendment to the Plan initiated by the Commission under Rule 608 of Regulation NMS.

IV. Trading Center Policies and Procedures

All trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the limit up - limit down requirements specified in Sections VI of the Plan, and to comply with the Trading Pauses specified in Section VII of the Plan.

V. Price Bands

(A) Calculation and Dissemination of Price Bands

(1) The Processor for each NMS stock shall calculate and disseminate to the public a Lower Price Band and an Upper Price Band during Regular Trading Hours for such NMS Stock. The Price Bands shall be based on a Reference Price for each NMS Stock that equals the arithmetic mean price of Eligible Reported Transactions for the NMS stock over the immediately preceding five-minute period (except for periods following openings and reopenings, which are addressed below). If no Eligible Reported Transactions for the NMS Stock have occurred over the immediately preceding five-minute period, the previous Reference Price shall remain in effect. The Price Bands for an NMS Stock shall be calculated by applying the Percentage Parameter for such NMS Stock to the Reference Price, with the Lower Price Band being a Percentage Parameter below the Reference Price, and the Upper Price Band being a Percentage Parameter above the Reference Price. The Price Bands shall be calculated during Regular Trading Hours. Between 9:30 a.m. and 9:45 a.m. ET, and 3:35 p.m. and 4:00 p.m. ET, or in the case of an early scheduled close, during the last 25 minutes of trading before the early scheduled close, the Price Bands shall be calculated by applying double the Percentage Parameters set forth in Appendix A. If a Reopening Price does not occur within ten minutes after the beginning of a Trading Pause, the Price Band, for the first 30 seconds following the reopening after that Trading Pause, shall be calculated by applying triple the Percentage Parameters set forth in Appendix A.

(2) The Processor shall calculate a Pro-Forma Reference Price on a continuous basis during Regular Trading Hours, as specified in Section V(A)(1) of the Plan. If a Pro-Forma

Reference Price has not moved by 1% or more from the Reference Price currently in effect, no new Price Bands shall be disseminated, and the current Reference Price shall remain the effective Reference Price. When the Pro-Forma Reference Price has moved by 1% or more from the Reference Price currently in effect, the Pro-Forma Reference Price shall become the Reference Price, and the Processor shall disseminate new Price Bands based on the new Reference Price; provided, however, that each new Reference Price shall remain in effect for at least 30 seconds.

(B) <u>Openings</u>

(1) Except when a Regulatory Halt is in effect at the start of Regular Trading Hours, the first Reference Price for a trading day shall be the Opening Price on the Primary Listing Exchange in an NMS Stock if such Opening Price occurs less than five minutes after the start of Regular Trading Hours. During the period less than five minutes after the Opening Price, a Pro-Forma Reference Price shall be updated on a continuous basis to be the arithmetic mean price of Eligible Reported Transactions for the NMS Stock during the period following the Opening Price (including the Opening Price), and if it differs from the current Reference Price by 1% or more shall become the new Reference Price, except that a new Reference Price shall remain in effect for at least 30 seconds. Subsequent Reference Prices shall be calculated as specified in Section V(A) of the Plan.

(2) If the Opening Price on the Primary Listing Exchange in an NMS Stock does not occur within five minutes after the start of Regular Trading Hours, the first Reference Price for a trading day shall be the arithmetic mean price of Eligible Reported Transactions for the NMS Stock over the preceding five minute time period, and subsequent Reference Prices shall be calculated as specified in Section V(A) of the Plan.

(C) Reopenings

(1) Following a Trading Pause in an NMS Stock, and if the Primary Listing Exchange has not declared a Regulatory Halt, the next Reference Price shall be the Reopening Price on the Primary Listing Exchange if such Reopening Price occurs within ten minutes after the beginning of the Trading Pause, and subsequent Reference Prices shall be determined in the manner prescribed for normal openings, as specified in Section V(B)(1) of the Plan. If such Reopening Price does not occur within ten minutes after the beginning of the Trading Pause, the first Reference Price following the Trading Pause shall be equal to the last effective Reference Price before the Trading Pause. Subsequent Reference Prices shall be calculated as specified in Section V(A) of the Plan.

(2) Following a Regulatory Halt, the next Reference Price shall be the Opening or Reopening Price on the Primary Listing Exchange if such Opening or Reopening Price occurs within five minutes after the end of the Regulatory Halt, and subsequent Reference Prices shall be determined in the manner prescribed for normal openings, as specified in Section V(B)(1) of the Plan. If such Opening or Reopening Price has not occurred within five minutes after the end of the Regulatory Halt, the Reference Price shall be equal to the arithmetic mean price of Eligible Reported Transactions for the NMS Stock over the preceding five minute time period, and subsequent Reference Prices shall be calculated as specified in Section V(A) of the Plan.

VI. Limit Up-Limit Down Requirements

(A) Limitations on Trades and Quotations Outside of Price Bands

(1) All trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trades at prices that are below the

Lower Price Band or above the Upper Price Band for an NMS Stock. Single-priced opening, reopening, and closing transactions on the Primary Listing Exchange, however, shall be excluded from this limitation. In addition, any transaction that both (i) does not update the last sale price (except if solely because the transaction was reported late or because the transaction was an odd-lot sized transaction), and (ii) is excepted or exempt from Rule 611 under Regulation NMS shall be excluded from this limitation.

(2) When a National Best Bid is below the Lower Price Band or a National Best Offer is above the Upper Price Band for an NMS Stock, the Processor shall disseminate such National Best Bid or National Best Offer with an appropriate flag identifying it as non-executable. When a National Best Offer is equal to the Lower Price Band or a National Best Bid is equal to the Upper Price Band for an NMS Stock, the Processor shall distribute such National Best Bid or National Best Offer with an appropriate flag identifying it as a "Limit State Quotation".

(3) All trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for an NMS Stock. The Processor shall disseminate an offer below the Lower Price Band or bid above the Upper Price Band that may be submitted despite such reasonable policies and procedures, but with an appropriate flag identifying it as non-executable; provided, however, that any such bid or offer shall not be included in National Best Bid or National Best Offer calculations.

(B) Entering and Exiting a Limit State

(1) All trading for an NMS Stock shall immediately enter a Limit State if the National Best Offer equals the Lower Price Band and does not cross the National Best Bid, or the National Best Bid equals the Upper Price Band and does not cross the National Best Offer.

(2) When trading for an NMS Stock enters a Limit State, the Processor shall disseminate this information by identifying the relevant quotation (i.e., a National Best Offer that equals the Lower Price Band or a National Best Bid that equals the Upper Price Band) as a Limit State Quotation. At this point, the Processor shall cease calculating and disseminating updated Reference Prices and Price Bands for the NMS Stock until either trading exits the Limit State or trading resumes with an opening or re-opening as provided in Section V.

(3) Trading for an NMS Stock shall exit a Limit State if, within 15 seconds of entering the Limit State, the entire size of all Limit State Quotations are executed or cancelled.

(4) If trading for an NMS Stock exits a Limit State within 15 seconds of entry, the Processor shall immediately calculate and disseminate updated Price Bands based on a Reference Price that equals the arithmetic mean price of Eligible Reported Transactions for the NMS Stock over the immediately preceding five-minute period (including the period of the Limit State).

(5) If trading for an NMS Stock does not exit a Limit State within 15 seconds of entry, the Limit State will terminate when the Primary Listing Exchange declares a Trading Pause pursuant to Section VII of the Plan or at the end of Regular Trading Hours.

VII. Trading Pauses

(A) Declaration of Trading Pauses

(1) If trading for an NMS Stock does not exit a Limit State within 15 seconds of entry during Regular Trading Hours, then the Primary Listing Exchange shall declare a Trading Pause for such NMS Stock and shall notify the Processor.

(2) The Primary Listing Exchange may also declare a Trading Pause for an NMS Stock when an NMS Stock is in a Straddle State, which is when National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS Stock is not in a Limit State, and trading in that NMS Stock deviates from normal trading characteristics such that declaring a Trading Pause would support the Plan's goal to address extraordinary market volatility. The Primary Listing Exchange shall develop policies and procedures for determining when it would declare a Trading Pause in such circumstances. If a Trading Pause is declared for an NMS Stock under this provision, the Primary Listing Exchange shall notify the Processor.

(3) The Processor shall disseminate Trading Pause information to the public. No trades in an NMS Stock shall occur during a Trading Pause, but all bids and offers may be displayed.

(B) <u>Reopening of Trading During Regular Trading Hours</u>

(1) Five minutes after declaring a Trading Pause for an NMS Stock, and if the Primary Listing Exchange has not declared a Regulatory Halt, the Primary Listing Exchange shall attempt to reopen trading using its established reopening procedures. The Trading Pause shall end when the Primary Listing Exchange reports a Reopening Price.

(2) The Primary Listing Exchange shall notify the Processor if it is unable to reopen trading in an NMS Stock for any reason other than a significant order imbalance and if it has not declared a Regulatory Halt. The Processor shall disseminate this information to the public, and all trading centers may begin trading the NMS Stock at this time.

(3) If the Primary Listing Exchange does not report a Reopening Price within ten minutes after the declaration of a Trading Pause in an NMS Stock, and has not declared a Regulatory Halt, all trading centers may begin trading the NMS Stock.

(4) When trading begins after a Trading Pause, the Processor shall update the Price Bands as set forth in Section V(C)(1) of the Plan.

(C) Trading Pauses Within Ten Minutes of the End of Regular Trading Hours

(1) If a Trading Pause for an NMS Stock is declared in the last ten minutes of trading before the end of Regular Trading Hours, the Primary Listing Exchange shall not reopen trading and shall attempt to execute a closing transaction using its established closing procedures. All trading centers may begin trading the NMS Stock when the Primary Listing Exchange executes a closing transaction.

(2) If the Primary Listing Exchange does not execute a closing transaction within five minutes after the end of Regular Trading Hours, all trading centers may begin trading the NMS Stock.

VIII. Implementation

The initial date of Plan operations shall be April 8, 2013.

(A) Phase I

(1) On the initial date of Plan operations, Phase I of Plan implementation shall begin in select symbols from the Tier 1 NMS Stocks identified in Appendix A of the Plan.

(2) Three months after the initial date of Plan operations, or such earlier date as may be announced by the Processor with at least 30 days notice, the Plan shall fully apply to all Tier 1 NMS Stocks identified in Appendix A of the Plan.

(3) During Phase I, the first Price Bands for a trading day shall be calculated and disseminated 15 minutes after the start of Regular Trading Hours as specified in Section (V)(A) of the Plan. No Price Bands shall be calculated and disseminated and therefore trading shall not enter a Limit State less than 30 minutes before the end of Regular Trading Hours.

(B) Phase II – Full Implementation

Phase II.A.: Eight months after the initial date of Plan operations, or such earlier date as may be announced by the Processor with at least 30 days notice, the Plan shall fully apply (i) to all NMS Stocks; and (ii) beginning at 9:30 a.m. ET, and ending at 3:45 p.m. ET each trading day, or earlier in the case of an early scheduled close.

Phase II.B.: By February 24, 2014, or such earlier date as may be announced by the Processor with at least 30 days notice, the Plan shall fully apply (i) to all NMS Stocks; and (ii) beginning at 9:30 a.m. ET, and ending at 4:00 p.m. ET each trading day, or earlier in the case of an early scheduled close.

(C) Pilot

The Plan shall be implemented on a [one-year] pilot basis set to end on February 20, 2015.

IX. Withdrawal from Plan

If a Participant obtains SEC approval to withdraw from the Plan, such Participant may withdraw from the Plan at any time on not less than 30 days' prior written notice to each of the other Participants. At such time, the withdrawing Participant shall have no further rights or obligations under the Plan.

X. Counterparts and Signatures

The Plan may be executed in any number of counterparts, no one of which need contain all signatures of all Participants, and as many of such counterparts as shall together contain all such signatures shall constitute one and the same instrument.

IN WITNESS THEREOF, this Plan has been executed as of the __ day of February 2014 by each of the parties hereto.

BATS EXCHANGE, INC.	BATS Y-EXCHANGE, INC.
BY:______________________	BY:______________________
CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED	CHICAGO STOCK EXCHANGE, INC.
BY:______________________	BY:______________________
EDGA EXCHANGE, INC.	EDGX EXCHANGE, INC.
BY:______________________	BY:______________________
FINANCIAL INDUSTRY REGULATORY AUTHORITY, INC.	NASDAQ OMX BX, INC.
BY:______________________	BY:______________________
NASDAQ OMX PHLX LLC	THE NASDAQ STOCK MARKET LLC
BY:______________________	BY:______________________
NATIONAL STOCK EXCHANGE, INC.	NEW YORK STOCK EXCHANGE LLC
BY:______________________	BY:______________________
NYSE MKT LLC	NYSE ARCA, INC.
BY:______________________	BY:______________________

Appendix A – Percentage Parameters

I. Tier 1 NMS Stocks

(1) Tier 1 NMS Stocks shall include all NMS Stocks included in the S&P 500 Index, the Russell 1000 Index, and the exchange-traded products ("ETP") listed on Schedule 1 to this Appendix. Schedule 1 to the Appendix will be reviewed and updated semi-annually based on the fiscal year by the Primary Listing Exchange to add ETPs that meet the criteria, or delete ETPs that are no longer eligible. To determine eligibility for an ETP to be included as a Tier 1 NMS Stock, all ETPs across multiple asset classes and issuers, including domestic equity, international equity, fixed income, currency, and commodities and futures will be identified. Leveraged ETPs will be excluded and the list will be sorted by notional consolidated average daily volume ("CADV"). The period used to measure CADV will be from the first day of the previous fiscal half year up until one week before the beginning of the next fiscal half year. Daily volumes will be multiplied by closing prices and then averaged over the period. ETPs, including inverse ETPs, that trade over $2,000,000 CADV will be eligible to be included as a Tier 1 NMS Stock. The semi-annual updates to Schedule 1 do not require an amendment to the Plan. The Primary Listing Exchanges will maintain the updated Schedule 1 on their respective websites.

(2) The Percentage Parameters for Tier 1 NMS Stocks with a Reference Price more than $3.00 shall be 5%.

(3) The Percentage Parameters for Tier 1 NMS Stocks with a Reference Price equal to $0.75 and up to and including $3.00 shall be 20%.

(4) The Percentage Parameters for Tier 1 NMS Stocks with a Reference Price less than $0.75 shall be the lesser of (a) $0.15 or (b) 75%.

(5) The Reference Price used for determining which Percentage Parameter shall be applicable during a trading day shall be based on the closing price of the NMS Stock on the Primary Listing Exchange on the previous trading day, or if no closing price exists, the last sale on the Primary Listing Exchange reported by the Processor.

II. Tier 2 NMS Stocks

(1) Tier 2 NMS Stocks shall include all NMS Stocks other than those in Tier 1, provided, however, that all rights and warrants are excluded from the Plan.

(2) The Percentage Parameters for Tier 2 NMS Stocks with a Reference Price more than $3.00 shall be **10**%.

(3) The Percentage Parameters for Tier 2 NMS Stocks with a Reference Price equal to $0.75 and up to and including $3.00 shall be 20%.

(4) The Percentage Parameters for Tier 2 NMS Stocks with a Reference Price less than $0.75 shall be the lesser of (a) $0.15 or (b) 75%.

(5) Notwithstanding the foregoing, the Percentage Parameters for a Tier 2 NMS Stock that is a leveraged ETP shall be the applicable Percentage Parameter set forth in clauses (2), (3), or (4) above, multiplied by the leverage ratio of such product.

(6) The Reference Price used for determining which Percentage Parameter shall be applicable during a trading day shall be based on the closing price of the NMS Stock on the Primary Listing Exchange on the previous trading day, or if no closing price exists, the last sale on the Primary Listing Exchange reported by the Processor.

Appendix A – Schedule 1

Ticker	Name	Primary Exchange
AAXJ	iShares MSCI All Country Asia ex Japan ETF	NASDAQ GM
ACWI	iShares MSCI ACWI ETF	NASDAQ GM
ACWV	iShares MSCI All Country World Minimum Volatility ETF	NYSE Arca
ACWX	iShares MSCI ACWI ex US ETF	NASDAQ GM
AGG	iShares Core Total US Bond Market ETF	NYSE Arca
AGZ	iShares Agency Bond ETF	NYSE Arca
ALD	WisdomTree Asia Local Debt Fund	NYSE Arca
AMJ	JPMorgan Alerian MLP Index ETN	NYSE Arca
AMLP	Alerian MLP ETF	NYSE Arca
ASHR	db X-trackers Harvest CSI 300 China A-Shares Fund	NYSE Arca
BAB	PowerShares Build America Bond Portfolio	NYSE Arca
BBH	Market Vectors Biotech ETF	NYSE Arca
BIL	SPDR Barclays 1-3 Month T-Bill	NYSE Arca
BIV	Vanguard Intermediate-Term Bond ETF	NYSE Arca
BKF	iShares MSCI BRIC ETF	NYSE Arca
BKLN	PowerShares Senior Loan Portfolio	NYSE Arca
BLV	Vanguard Long-Term Bond ETF	NYSE Arca
BND	Vanguard Total Bond Market ETF	NYSE Arca
BNDX	Vanguard Total International Bond ETF	NASDAQ GM
BNO	United States Brent Oil Fund LP	NYSE Arca
BOND	Pimco Total Return ETF	NYSE Arca
BRF	Market Vectors Brazil Small-Cap ETF	NYSE Arca
BSCE	Guggenheim BulletShares 2014 Corporate Bond ETF	NYSE Arca
BSCF	Guggenheim BulletShares 2015 Corporate Bond ETF	NYSE Arca
BSCG	Guggenheim BulletShares 2016 Corporate Bond ETF	NYSE Arca
BSCH	Guggenheim BulletShares 2017 Corporate Bond ETF	NYSE Arca
BSJE	Guggenheim BulletShares 2014 High Yield Corporate Bond ETF	NYSE Arca
BSJF	Guggenheim BulletShares 2015 High Yield Corporate Bond ETF	NYSE Arca
BSJG	Guggenheim BulletShares 2016 High Yield Corporate Bond ETF	NYSE Arca
BSV	Vanguard Short-Term Bond ETF	NYSE Arca
BWX	SPDR Barclays International Treasury Bond ETF	NYSE Arca
BZF	WisdomTree Brazilian Real Fund	NYSE Arca
CFT	iShares Credit Bond ETF	NYSE Arca
CIU	iShares Intermediate Credit Bond ETF	NYSE Arca
CLY	iShares 10+ Year Credit Bond ETF	NYSE Arca
CORN	Teucrium Corn Fund	NYSE Arca

Ticker	Name	Primary Exchange
CSD	Guggenheim Spin-Off ETF	NYSE Arca
CSJ	iShares 1-3 Year Credit Bond ETF	NYSE Arca
CVY	Guggenheim Multi-Asset Income ETF	NYSE Arca
CWB	SPDR Barclays Convertible Securities ETF	NYSE Arca
DBA	PowerShares DB Agriculture Fund	NYSE Arca
DBB	PowerShares DB Base Metals Fund	NYSE Arca
DBC	PowerShares DB Commodity Index Tracking Fund	NYSE Arca
DBJP	db X-trackers MSCI Japan Hedged Equity Fund	NYSE Arca
DBO	PowerShares DB Oil Fund	NYSE Arca
DBP	PowerShares DB Precious Metals Fund	NYSE Arca
DBV	PowerShares DB G10 Currency Harvest Fund	NYSE Arca
DEM	WisdomTree Emerging Markets Equity Income Fund	NYSE Arca
DES	WisdomTree SmallCap Dividend Fund	NYSE Arca
DFE	WisdomTree Europe SmallCap Dividend Fund	NYSE Arca
DGS	WisdomTree Emerging Markets SmallCap Dividend Fund	NYSE Arca
DGZ	PowerShares DB Gold Short ETN	NYSE Arca
DHS	WisdomTree Equity Income Fund	NYSE Arca
DIA	SPDR Dow Jones Industrial Average ETF Trust	NYSE Arca
DJP	iPath Dow Jones-UBS Commodity Index Total Return ETN	NYSE Arca
DLN	WisdomTree LargeCap Dividend Fund	NYSE Arca
DLS	WisdomTree International SmallCap Dividend Fund	NYSE Arca
DOG	ProShares Short Dow30	NYSE Arca
DON	WisdomTree MidCap Dividend Fund	NYSE Arca
DTN	WisdomTree Dividend Ex-Financials Fund	NYSE Arca
DTYS	iPath US Treasury 10-year Bear ETN	NYSE Arca
DVY	iShares Select Dividend ETF	NYSE Arca
DWAS	PowerShares DWA SmallCap Momentum Portfolio	NYSE Arca
DWX	SPDR S&P International Dividend ETF	NYSE Arca
DXJ	WisdomTree Japan Hedged Equity Fund	NYSE Arca
EBND	SPDR Barclays Emerging Markets Local Bond ETF	NYSE Arca
ECH	iShares MSCI Chile Capped ETF	NYSE Arca
ECON	EGShares Emerging Markets Consumer ETF	NYSE Arca
EDIV	SPDR S&P Emerging Markets Dividend ETF	NYSE Arca
EDV	Vanguard Extended Duration Treasury ETF	NYSE Arca
EEB	Guggenheim BRIC ETF	NYSE Arca
EEM	iShares MSCI Emerging Markets ETF	NYSE Arca
EEMV	iShares MSCI Emerging Markets Minimum Volatility ETF	NYSE Arca
EES	WisdomTree SmallCap Earnings Fund	NYSE Arca
EFA	iShares MSCI EAFE ETF	NYSE Arca

Ticker	Name	Primary Exchange
EFAV	iShares MSCI EAFE Minimum Volatility ETF	NYSE Arca
EFG	iShares MSCI EAFE Growth ETF	NYSE Arca
EFV	iShares MSCI EAFE Value ETF	NYSE Arca
EFZ	ProShares Short MSCI EAFE	NYSE Arca
EIDO	iShares MSCI Indonesia ETF	NYSE Arca
ELD	WisdomTree Emerging Markets Local Debt Fund	NYSE Arca
EMB	iShares JP Morgan USD Emerging Markets Bond ETF	NYSE Arca
EMLC	Market Vectors Emerging Markets Local Currency Bond ETF	NYSE Arca
EMLP	First Trust North American Energy Infrastructure Fund	NYSE Arca
EPHE	iShares MSCI Philippines ETF	NYSE Arca
EPI	WisdomTree India Earnings Fund	NYSE Arca
EPOL	iShares MSCI Poland Capped ETF	NYSE Arca
EPP	iShares MSCI Pacific ex Japan ETF	NYSE Arca
EPU	iShares MSCI All Peru Capped ETF	NYSE Arca
ERUS	iShares MSCI Russia Capped ETF	NYSE Arca
EUFN	iShares MSCI Europe Financials ETF	NASDAQ GM
EUM	ProShares Short MSCI Emerging Markets	NYSE Arca
EWA	iShares MSCI Australia ETF	NYSE Arca
EWC	iShares MSCI Canada ETF	NYSE Arca
EWD	iShares MSCI Sweden ETF	NYSE Arca
EWG	iShares MSCI Germany ETF	NYSE Arca
EWH	iShares MSCI Hong Kong ETF	NYSE Arca
EWI	iShares MSCI Italy Capped ETF	NYSE Arca
EWJ	iShares MSCI Japan ETF	NYSE Arca
EWL	iShares MSCI Switzerland Capped ETF	NYSE Arca
EWM	iShares MSCI Malaysia ETF	NYSE Arca
EWN	iShares MSCI Netherlands ETF	NYSE Arca
EWP	iShares MSCI Spain Capped ETF	NYSE Arca
EWQ	iShares MSCI France ETF	NYSE Arca
EWS	iShares MSCI Singapore ETF	NYSE Arca
EWT	iShares MSCI Taiwan ETF	NYSE Arca
EWU	iShares MSCI United Kingdom ETF	NYSE Arca
EWW	iShares MSCI Mexico Capped ETF	NYSE Arca
EWX	SPDR S&P Emerging Markets SmallCap ETF	NYSE Arca
EWY	iShares MSCI South Korea Capped ETF	NYSE Arca
EWZ	iShares MSCI Brazil Capped ETF	NYSE Arca
EXI	iShares Global Industrials ETF	NYSE Arca
EZA	iShares MSCI South Africa ETF	NYSE Arca
EZM	WisdomTree MidCap Earnings Fund	NYSE Arca

Ticker	Name	Primary Exchange
EZU	iShares MSCI EMU ETF	NYSE Arca
FBT	First Trust NYSE Arca Biotechnology Index Fund	NYSE Arca
FCG	First Trust ISE-Revere Natural Gas Index Fund	NYSE Arca
FDL	First Trust Morningstar Dividend Leaders Index	NYSE Arca
FDN	First Trust Dow Jones Internet Index Fund	NYSE Arca
FEM	First Trust Emerging Markets AlphaDEX Fund	NYSE Arca
FEP	First Trust Europe AlphaDEX Fund	NYSE Arca
FEX	First Trust Large Cap Core AlphaDEX Fund	NYSE Arca
FEZ	SPDR EURO STOXX 50 ETF	NYSE Arca
FGD	First Trust DJ Global Select Dividend Index Fund	NYSE Arca
FLOT	iShares Floating Rate Bond ETF	NYSE Arca
FLRN	SPDR Barclays Investment Grade Floating Rate ETF	NYSE Arca
FM	iShares MSCI Frontier 100 ETF	NYSE Arca
FNX	First Trust Mid Cap Core AlphaDEX Fund	NYSE Arca
FPX	First Trust US IPO Index Fund	NYSE Arca
FRI	First Trust S&P REIT Index Fund	NYSE Arca
FTA	First Trust Large Cap Value AlphaDEX Fund	NYSE Arca
FVD	First Trust Value Line Dividend Index Fund	NYSE Arca
FXA	CurrencyShares Australian Dollar Trust	NYSE Arca
FXB	CurrencyShares British Pound Sterling Trust	NYSE Arca
FXC	CurrencyShares Canadian Dollar Trust	NYSE Arca
FXD	First Trust Consumer Discretionary AlphaDEX Fund	NYSE Arca
FXE	CurrencyShares Euro Trust	NYSE Arca
FXF	CurrencyShares Swiss Franc Trust	NYSE Arca
FXG	First Trust Consumer Staples AlphaDEX Fund	NYSE Arca
FXH	First Trust Health Care AlphaDEX Fund	NYSE Arca
FXI	iShares China Large-Cap ETF	NYSE Arca
FXL	First Trust Technology AlphaDEX Fund	NYSE Arca
FXN	First Trust Energy AlphaDEX Fund	NYSE Arca
FXO	First Trust Financial AlphaDEX Fund	NYSE Arca
FXR	First Trust Industrials/Producer Durables AlphaDEX Fund	NYSE Arca
FXU	First Trust Utilities AlphaDEX Fund	NYSE Arca
FXY	CurrencyShares Japanese Yen Trust	NYSE Arca
FXZ	First Trust Materials AlphaDEX Fund	NYSE Arca
FYX	First Trust Small Cap Core AlphaDEX Fund	NYSE Arca
GCC	GreenHaven Continuous Commodity Index Fund	NYSE Arca
GDX	Market Vectors Gold Miners ETF	NYSE Arca
GDXJ	Market Vectors Junior Gold Miners ETF	NYSE Arca
GLD	SPDR Gold Shares	NYSE Arca

Ticker	Name	Primary Exchange
GLTR	ETFS Physical Precious Metal Basket Shares	NYSE Arca
GMF	SPDR S&P Emerging Asia Pacific ETF	NYSE Arca
GMM	SPDR S&P Emerging Markets ETF	NYSE Arca
GNR	SPDR S&P Global Natural Resources ETF	NYSE Arca
GSG	iShares S&P GSCI Commodity Indexed Trust	NYSE Arca
GSY	Guggenheim Enhanced Short Duration ETF	NYSE Arca
GUNR	FlexShares Global Upstream Natural Resources Index Fund	NYSE Arca
GURU	Global X Guru Index ETF	NYSE Arca
GVI	iShares Intermediate Government/Credit Bond ETF	NYSE Arca
GWL	SPDR S&P World ex-US ETF	NYSE Arca
GWX	SPDR S&P International Small Cap ETF	NYSE Arca
GXC	SPDR S&P China ETF	NYSE Arca
GXG	Global X FTSE Colombia 20 ETF	NYSE Arca
HAO	Guggenheim China Small Cap ETF	NYSE Arca
HDGE	Ranger Equity Bear ETF	NYSE Arca
HDV	iShares High Dividend ETF	NYSE Arca
HEDJ	WisdomTree Europe Hedged Equity Fund	NYSE Arca
HYD	Market Vectors High Yield Municipal Index ETF	NYSE Arca
HYEM	Market Vectors Emerging High Yield Bond ETF	NYSE Arca
HYG	iShares iBoxx $ High Yield Corporate Bond ETF	NYSE Arca
HYLD	Peritus High Yield ETF	NYSE Arca
HYMB	SPDR Nuveen S&P High Yield Municipal Bond ETF	NYSE Arca
HYS	PIMCO 0-5 Year High Yield Corporate Bond Index Exchange-Traded Fund	NYSE Arca
IAI	iShares U.S. Broker-Dealers ETF	NYSE Arca
IAT	iShares US Regional Banks ETF	NYSE Arca
IAU	iShares Gold Trust	NYSE Arca
IBB	iShares Nasdaq Biotechnology ETF	NASDAQ GM
IBND	SPDR Barclays International Corporate Bond ETF	NYSE Arca
ICF	iShares Cohen & Steers REIT ETF	NYSE Arca
IDU	iShares US Utilities ETF	NYSE Arca
IDV	iShares International Select Dividend ETF	NYSE Arca
IDX	Market Vectors Indonesia Index ETF	NYSE Arca
IEF	iShares 7-10 Year Treasury Bond ETF	NYSE Arca
IEFA	iShares Core MSCI EAFE ETF	NYSE Arca
IEI	iShares 3-7 Year Treasury Bond ETF	NYSE Arca
IEMG	iShares Core MSCI Emerging Markets ETF	NYSE Arca
IEO	iShares U.S. Oil & Gas Exploration & Production ETF	NYSE Arca
IEV	iShares Europe ETF	NYSE Arca

Ticker	Name	Primary exchange
IEZ	iShares U.S. Oil Equipment & Services ETF	NYSE Arca
IFGL	iShares International Developed Real Estate ETF	NASDAQ GM
IGE	iShares North American Natural Resources ETF	NYSE Arca
IGF	iShares Global Infrastructure ETF	NYSE Arca
IGM	iShares North American Tech ETF	NYSE Arca
IGOV	iShares International Treasury Bond ETF	NASDAQ GM
IGV	iShares North American Tech-Software ETF	NYSE Arca
IHE	iShares US Pharmaceuticals ETF	NYSE Arca
IHF	iShares U.S. Healthcare Providers ETF	NYSE Arca
IHI	iShares U.S. Medical Devices ETF	NYSE Arca
IHY	Market Vectors International High Yield Bond ETF	NYSE Arca
IJH	iShares Core S&P Mid-Cap ETF	NYSE Arca
IJJ	iShares S&P Mid-Cap 400 Value ETF	NYSE Arca
IJK	iShares S&P Mid-Cap 400 Growth ETF	NYSE Arca
IJR	iShares Core S&P Small-Cap ETF	NYSE Arca
IJS	iShares S&P Small-Cap 600 Value ETF	NYSE Arca
IJT	iShares S&P Small-Cap 600 Growth ETF	NYSE Arca
ILF	iShares Latin America 40 ETF	NYSE Arca
INDA	iShares MSCI India ETF	BATS
INDY	iShares India 50 ETF	NASDAQ GM
INP	iPath MSCI India Index ETN	NYSE Arca
IOO	iShares Global 100 ETF	NYSE Arca
IPE	SPDR Barclays TIPS ETF	NYSE Arca
ITA	iShares U.S. Aerospace & Defense ETF	NYSE Arca
ITB	iShares U.S. Home Construction ETF	NYSE Arca
ITM	Market Vectors Intermediate Municipal ETF	NYSE Arca
ITOT	iShares Core S&P Total US Stock Market ETF	NYSE Arca
ITR	SPDR Barclays Intermediate Term Corporate Bond ETF	NYSE Arca
IVE	iShares S&P 500 Value ETF	NYSE Arca
IVV	iShares Core S&P 500 ETF	NYSE Arca
IVW	iShares S&P 500 Growth ETF	NYSE Arca
IWB	iShares Russell 1000 ETF	NYSE Arca
IWC	iShares Micro-Cap ETF	NYSE Arca
IWD	iShares Russell 1000 Value ETF	NYSE Arca
IWF	iShares Russell 1000 Growth ETF	NYSE Arca
IWM	iShares Russell 2000 ETF	NYSE Arca
IWN	iShares Russell 2000 Value ETF	NYSE Arca
IWO	iShares Russell 2000 Growth ETF	NYSE Arca
IWP	iShares Russell Mid-Cap Growth ETF	NYSE Arca

Ticker	Name	Primary Exchange
IWR	iShares Russell Mid-Cap ETF	NYSE Arca
IWS	iShares Russell Mid-Cap Value ETF	NYSE Arca
IWV	iShares Russell 3000 ETF	NYSE Arca
IWW	iShares Russell 3000 Value ETF	NYSE Arca
IXC	iShares Global Energy ETF	NYSE Arca
IXG	iShares Global Financials ETF	NYSE Arca
IXJ	iShares Global Healthcare ETF	NYSE Arca
IXN	iShares Global Tech ETF	NYSE Arca
IXP	iShares Global Telecom ETF	NYSE Arca
IXUS	iShares Core MSCI Total International Stock ETF	NYSE Arca
IYC	iShares U.S. Consumer Services ETF	NYSE Arca
IYE	iShares U.S. Energy ETF	NYSE Arca
IYF	iShares US Financials ETF	NYSE Arca
IYG	iShares U.S. Financial Services ETF	NYSE Arca
IYH	iShares U.S. Healthcare ETF	NYSE Arca
IYJ	iShares U.S. Industrials ETF	NYSE Arca
IYM	iShares U.S. Basic Materials ETF	NYSE Arca
IYR	iShares US Real Estate ETF	NYSE Arca
IYT	iShares Transportation Average ETF	NYSE Arca
IYW	iShares US Technology ETF	NYSE Arca
IYY	iShares Dow Jones U.S. ETF	NYSE Arca
IYZ	iShares US Telecommunications ETF	NYSE Arca
JKE	iShares Morningstar Large-Cap Growth ETF	NYSE Arca
JKF	iShares Morningstar Large-Cap Value ETF	NYSE Arca
JNK	SPDR Barclays High Yield Bond ETF	NYSE Arca
JO	iPath Dow Jones-UBS Coffee Subindex Total Return ETN	NYSE Arca
KBE	SPDR S&P Bank ETF	NYSE Arca
KBWB	PowerShares KBW Bank Portfolio	NYSE Arca
KIE	SPDR S&P Insurance ETF	NYSE Arca
KOL	Market Vectors Coal ETF	NYSE Arca
KRE	SPDR S&P Regional Banking ETF	NYSE Arca
KXI	iShares Global Consumer Staples ETF	NYSE Arca
LAG	SPDR Barclays Aggregate Bond ETF	NYSE Arca
LEMB	iShares Emerging Markets Local Currency Bond ETF	NYSE Arca
LQD	iShares iBoxx $ Investment Grade Corporate Bond ETF	NYSE Arca
MBB	iShares MBS ETF	NYSE Arca
MCHI	iShares MSCI China ETF	NYSE Arca
MDIV	First Trust NASDAQ US Multi-Asset Diversified Income Index Fun	NASDAQ GM
MDY	SPDR S&P MidCap 400 ETF Trust	NYSE Arca

Ticker	Name	Primary Exchange
MGC	Vanguard Mega Cap ETF	NYSE Arca
MGK	Vanguard Mega Cap Growth ETF	NYSE Arca
MGV	Vanguard Mega Cap Value ETF	NYSE Arca
MINT	PIMCO Enhanced Short Maturity Exchange-Traded Fund	NYSE Arca
MLPI	ETRACS Alerian MLP Infrastructure Index ETN	NYSE Arca
MLPN	Credit Suisse MLP Equal Weight Index ETN	NYSE Arca
MOAT	Market Vectors Wide Moat ETF	NYSE Arca
MOO	Market Vectors Agribusiness ETF	NYSE Arca
MUB	iShares National AMT-Free Muni Bond ETF	NYSE Arca
MUNI	PIMCO Intermediate Municipal Bond Exchange-Traded Fund	NYSE Arca
MXI	iShares Global Materials ETF	NYSE Arca
NEAR	iShares Short Maturity Bond ETF	BATS
NKY	MAXIS Nikkei 225 Index Fund ETF	NYSE Arca
NOBL	ProShares S&P 500 Aristocrats ETF	NYSE Arca
OEF	iShares S&P 100 ETF	NYSE Arca
OIH	Market Vectors Oil Service ETF	NYSE Arca
OIL	iPath Goldman Sachs Crude Oil Total Return Index ETN	NYSE Arca
ONEQ	Fidelity NASDAQ Composite Index Tracking Stock ETF	NASDAQ GM
PALL	ETFS Physical Palladium Shares	NYSE Arca
PBE	Powershares Dynamic Biotechnology & Genome Portfolio	NYSE Arca
PBS	Powershares Dynamic Media Portfolio	NYSE Arca
PBW	Powershares WilderHill Clean Energy Portfolio	NYSE Arca
PCEF	PowerShares CEF Income Composite Portfolio	NYSE Arca
PCY	PowerShares Emerging Markets Sovereign Debt Portfolio	NYSE Arca
PDP	PowerShares DWA Momentum Portfolio	NYSE Arca
PFF	iShares US Preferred Stock ETF	NYSE Arca
PGF	PowerShares Financial Preferred Portfolio	NYSE Arca
PGJ	Powershares Golden Dragon China Portfolio	NYSE Arca
PGX	PowerShares Preferred Portfolio	NYSE Arca
PHB	PowerShares Fundamental High Yield Corporate Bond Portfolio	NYSE Arca
PHO	PowerShares Water Resources Portfolio	NYSE Arca
PHYS	Sprott Physical Gold Trust	NYSE Arca
PID	PowerShares International Dividend Achievers Portfolio	NYSE Arca
PIE	PowerShares DWA Emerging Markets Momentum Portfolio	NYSE Arca
PIN	PowerShares India Portfolio	NYSE Arca
PIZ	PowerShares DWA Developed Markets Momentum Portfolio	NYSE Arca
PJP	Powershares Dynamic Pharmaceuticals Portfolio	NYSE Arca
PKW	PowerShares Buyback Achievers Portfolio	NYSE Arca
PNQI	PowerShares NASDAQ Internet Portfolio	NASDAQ GM

Ticker	Name	Primary Exchange
PPH	Market Vectors Pharmaceutical ETF	NYSE Arca
PPLT	ETFS Platinum Trust	NYSE Arca
PRF	Powershares FTSE RAFI US 1000 Portfolio	NYSE Arca
PRFZ	PowerShares FTSE RAFI US 1500 Small-Mid Portfolio	NASDAQ GM
PSK	SPDR Wells Fargo Preferred Stock ETF	NYSE Arca
PSLV	Sprott Physical Silver Trust	NYSE Arca
PSP	PowerShares Global Listed Private Equity Portfolio	NYSE Arca
PSQ	ProShares Short QQQ	NYSE Arca
PWV	PowerShares Dynamic Large Cap Value Portfolio	NYSE Arca
PXF	PowerShares FTSE RAFI Developed Markets ex-U.S. Portfolio	NYSE Arca
PZA	PowerShares Insured National Municipal Bond Portfolio	NYSE Arca
QAI	IndexIQ ETF Trust - IQ Hedge Multi-Strategy Tracker ETF	NYSE Arca
QQEW	First Trust NASDAQ-100 Equal Weighted Index Fund	NASDAQ GM
QQQ	Powershares QQQ Trust Series 1	NASDAQ GM
REM	iShares Mortgage Real Estate Capped ETF	NYSE Arca
REZ	iShares Residential Real Estate Capped ETF	NYSE Arca
RFG	Guggenheim S&P Midcap 400 Pure Growth ETF	NYSE Arca
RIGS	Riverfront Strategic Income Fund	NYSE Arca
RJI	ELEMENTS Linked to the Rogers International Commodity Index - Total Return	NYSE Arca
RPG	Guggenheim S&P 500 Pure Growth ETF	NYSE Arca
RPV	Guggenheim S&P 500 Pure Value ETF	NYSE Arca
RSP	Guggenheim S&P 500 Equal Weight ETF	NYSE Arca
RSX	Market Vectors Russia ETF	NYSE Arca
RTH	Market Vectors Retail ETF	NYSE Arca
RWM	ProShares Short Russell2000	NYSE Arca
RWO	SPDR Dow Jones Global Real Estate ETF	NYSE Arca
RWR	SPDR Dow Jones REIT ETF	NYSE Arca
RWX	SPDR Dow Jones International Real Estate ETF	NYSE Arca
RXI	iShares Global Consumer Discretionary ETF	NYSE Arca
RYH	Guggenheim S&P 500 Equal Weight Healthcare ETF	NYSE Arca
RYT	Guggenheim S&P 500 Equal Weight Technology ETF	NYSE Arca
SCHA	Schwab US Small-Cap ETF	NYSE Arca
SCHB	Schwab US Broad Market ETF	NYSE Arca
SCHD	Schwab US Dividend Equity ETF	NYSE Arca
SCHE	Schwab Emerging Markets Equity ETF	NYSE Arca
SCHF	Schwab International Equity ETF	NYSE Arca
SCHG	Schwab U.S. Large-Cap Growth ETF	NYSE Arca
SCHH	Schwab U.S. REIT ETF	NYSE Arca

Ticker	Name	Primary Exchange
SCHM	Schwab U.S. Mid-Cap ETF	NYSE Arca
SCHO	Schwab Short-Term U.S. Treasury ETF	NYSE Arca
SCHP	Schwab U.S. TIPs ETF	NYSE Arca
SCHR	Schwab Intermediate-Term U.S. Treasury ETF	NYSE Arca
SCHV	Schwab U.S. Large-Cap Value ETF	NYSE Arca
SCHX	Schwab US Large-Cap ETF	NYSE Arca
SCHZ	Schwab U.S. Aggregate Bond ETF	NYSE Arca
SCIF	Market Vectors India Small-Cap Index ETF	NYSE Arca
SCPB	SPDR Barclays Short Term Corporate Bond ETF	NYSE Arca
SCZ	iShares MSCI EAFE Small-Cap ETF	NYSE Arca
SDIV	Global X SuperDividend ETF	NYSE Arca
SDOG	ALPS Sector Dividend Dogs ETF	NYSE Arca
SDY	SPDR S&P Dividend ETF	NYSE Arca
SGOL	ETFS Gold Trust	NYSE Arca
SH	ProShares Short S&P500	NYSE Arca
SHM	SPDR Nuveen Barclays Short Term Municipal Bond ETF	NYSE Arca
SHV	iShares Short Treasury Bond ETF	NYSE Arca
SHY	iShares 1-3 Year Treasury Bond ETF	NYSE Arca
SIL	Global X Silver Miners ETF	NYSE Arca
SIVR	ETFS Physical Silver Shares	NYSE Arca
SJNK	SPDR Barclays Short Term High Yield Bond ETF	NYSE Arca
SLV	iShares Silver Trust	NYSE Arca
SLX	Market Vectors Steel Index Fund	NYSE Arca
SLY	SPDR S&P 600 Small CapETF	NYSE Arca
SMH	Market Vectors Semiconductor ETF	NYSE Arca
SOCL	Global X Social Media Index ETF	NASDAQ GM
SOXX	iShares PHLX Semiconductor ETF	NASDAQ GM
SPHB	PowerShares S&P 500 High Beta Port ETF	NYSE Arca
SPLV	PowerShares S&P 500 Low Volatility Portfolio	NYSE Arca
SPY	SPDR S&P 500 ETF Trust	NYSE Arca
SRLN	SPDR Blackstone / GSO Senior Loan ETF	NYSE Arca
STIP	iShares 0-5 Year TIPS Bond ETF	NYSE Arca
STPZ	PIMCO 1-5 Year U.S. TIPS Index Exchange-Traded Fund	NYSE Arca
SUB	iShares Short-Term National AMT-Free Muni Bond ETF	NYSE Arca
SVXY	ProShares Short VIX Short-Term Futures ETF	NYSE Arca
TAN	Guggenheim Solar ETF	NYSE Arca
TBF	ProShares Short 20+ Year Treasury	NYSE Arca
TDTF	FlexShares iBoxx 5-Year Target Duration TIPS Index Fund	NYSE Arca
TDTT	FlexShares iBoxx 3-Year Target Duration TIPS Index Fund	NYSE Arca

Ticker	Name	Primary Exchange
TFI	SPDR Nuveen Barclays Municipal Bond ETF	NYSE Arca
THD	iShares MSCI Thailand Capped ETF	NYSE Arca
TIP	iShares TIPS Bond ETF	NYSE Arca
TLH	iShares 10-20 Year Treasury Bond ETF	NYSE Arca
TLT	iShares 20+ Year Treasury Bond ETF	NYSE Arca
TLTD	FlexShares Morningstar Developed Markets ex-US Factor Tilt Index Fund	NYSE Arca
TOK	iShares MSCI Kokusai ETF	NYSE Arca
TUR	iShares MSCI Turkey ETF	NYSE Arca
UNG	United States Natural Gas Fund LP	NYSE Arca
USCI	United States Commodity Index Fund	NYSE Arca
USDU	WisdomTree Bloomberg U.S. Dollar Bullish Fund	NYSE Arca
USMV	iShares MSCI USA Minimum Volatility ETF	NYSE Arca
USO	United States Oil Fund LP	NYSE Arca
UUP	PowerShares DB US Dollar Index Bullish Fund	NYSE Arca
VAW	Vanguard Materials ETF	NYSE Arca
VB	Vanguard Small-Cap ETF	NYSE Arca
VBK	Vanguard Small-Cap Growth ETF	NYSE Arca
VBR	Vanguard Small-Cap Value ETF	NYSE Arca
VCIT	Vanguard Intermediate-Term Corporate Bond ETF	NASDAQ GM
VCLT	Vanguard Long-Term Corporate Bond ETF	NASDAQ GM
VCR	Vanguard Consumer Discretionary ETF	NYSE Arca
VCSH	Vanguard Short-Term Corporate Bond ETF	NASDAQ GM
VDC	Vanguard Consumer Staples ETF	NYSE Arca
VDE	Vanguard Energy ETF	NYSE Arca
VEA	Vanguard FTSE Developed Markets ETF	NYSE Arca
VEU	Vanguard FTSE All-World ex-US ETF	NYSE Arca
VFH	Vanguard Financials ETF	NYSE Arca
VGK	Vanguard FTSE Europe ETF	NYSE Arca
VGSH	Vanguard Short-Term Government Bond ETF	NASDAQ GM
VGT	Vanguard Information Technology ETF	NYSE Arca
VHT	Vanguard Health Care ETF	NYSE Arca
VIDI	Vident International Equity Fund	NASDAQ GM
VIG	Vanguard Dividend Appreciation ETF	NYSE Arca
VIIX	VelocityShares VIX Short Term ETN	NASDAQ GM
VIS	Vanguard Industrials ETF	NYSE Arca
VIXM	ProShares VIX Mid-Term Futures ETF	NYSE Arca
VIXY	ProShares VIX Short-Term Futures ETF	NYSE Arca
VMBS	Vanguard Mortgage-Backed Securities ETF	NASDAQ GM

Ticker	Name	Primary Exchange
VNM	Market Vectors Vietnam ETF	NYSE Arca
VNQ	Vanguard REIT ETF	NYSE Arca
VNQI	Vanguard Global ex-U.S. Real Estate ETF	NASDAQ GM
VO	Vanguard Mid-Cap ETF	NYSE Arca
VOE	Vanguard Mid-Cap Value ETF	NYSE Arca
VOO	Vanguard S&P 500 ETF	NYSE Arca
VOT	Vanguard Mid-Cap Growth ETF	NYSE Arca
VOX	Vanguard Telecommunication Services ETF	NYSE Arca
VPL	Vanguard FTSE Pacific ETF	NYSE Arca
VPU	Vanguard Utilities ETF	NYSE Arca
VQT	Barclays ETN+ ETNs Linked to the S&P 500 Dynamic VEQTORTM TotaL Return Index	NYSE Arca
VSS	Vanguard FTSE All World ex-US Small-Cap ETF	NYSE Arca
VT	Vanguard Total World Stock ETF	NYSE Arca
VTI	Vanguard Total Stock Market ETF	NYSE Arca
VTIP	Vanguard Short-Term Inflation-Protected Securities ETF	NASDAQ GM
VTV	Vanguard Value ETF	NYSE Arca
VTWO	Vanguard Russell 2000	NASDAQ GM
VUG	Vanguard Growth ETF	NYSE Arca
VV	Vanguard Large-Cap ETF	NYSE Arca
VWO	Vanguard FTSE Emerging Markets ETF	NYSE Arca
VXF	Vanguard Extended Market ETF	NYSE Arca
VXUS	Vanguard Total International Stock ETF	NASDAQ GM
VXX	iPATH S&P 500 VIX Short-Term Futures ETN	NYSE Arca
VXZ	iPATH S&P 500 VIX Mid-Term Futures ETN	NYSE Arca
VYM	Vanguard High Dividend Yield ETF	NYSE Arca
WIP	SPDR DB International Government Inflation-Protected Bond ETF	NYSE Arca
XBI	SPDR S&P Biotech ETF	NYSE Arca
XES	SPDR S&P Oil & Gas Equipment & Services ETF	NYSE Arca
XHB	SPDR S&P Homebuilders ETF	NYSE Arca
XIV	VelocityShares Daily Inverse VIX Short Term ETN	NASDAQ GM
XLB	Materials Select Sector SPDR Fund	NYSE Arca
XLE	Energy Select Sector SPDR Fund	NYSE Arca
XLF	Financial Select Sector SPDR Fund	NYSE Arca
XLG	Guggenheim Russell Top 50 Mega Cap ETF	NYSE Arca
XLI	Industrial Select Sector SPDR Fund	NYSE Arca
XLK	Technology Select Sector SPDR Fund	NYSE Arca
XLP	Consumer Staples Select Sector SPDR Fund	NYSE Arca
XLU	Utilities Select Sector SPDR Fund	NYSE Arca

Ticker	Name	Primary Exchange
XLV	Health Care Select Sector SPDR Fund	NYSE Arca
XLY	Consumer Discretionary Select Sector SPDR Fund	NYSE Arca
XME	SPDR S&P Metals & Mining ETF	NYSE Arca
XOP	SPDR S&P Oil & Gas Exploration & Production ETF	NYSE Arca
XPH	SPDR S&P Pharmaceuticals ETF	NYSE Arca
XRT	SPDR S&P Retail ETF	NYSE Arca
XSD	SPDR S&P Semiconductor ETF	NYSE Arca
ZIV	VelocityShares Daily Inverse VIX Medium Term ETN	NASDAQ GM
ZROZ	PIMCO 25+ Year Zero Coupon U.S. Treasury Index Exchange-Traded Fund	NYSE Arca

Appendix B – Data

Unless otherwise specified, the following data shall be collected and transmitted to the SEC in an agreed-upon format on a monthly basis, to be provided 30 calendar days following month end. Unless otherwise specified, the Primary Listing Exchanges shall be responsible for collecting and transmitting the data to the SEC. Data collected in connection with Sections II(E) – (G) below shall be transmitted to the SEC with a request for confidential treatment under the Freedom of Information Act. 5 U.S.C. 552, and the SEC's rules and regulations thereunder.

I. Summary Statistics

A. Frequency with which NMS Stocks enter a Limit State. Such summary data shall be broken down as follows:

1.Partition stocks by category

a. Tier 1 non-ETP issues > $3.00

b. Tier 1 non-ETP issues >= $0.75 and <= $3.00

c. Tier 1 non-ETP issues < $0.75

d. Tier 1 non-leveraged ETPs in each of above categories

e. Tier 1 leveraged ETPs in each of above categories

f. Tier 2 non-ETPs in each of above categories

g. Tier 2 non-leveraged ETPs in each of above categories

h. Tier 2 leveraged ETPs in each of above categories

2.Partition by time of day

a. Opening (prior to 9:45 am ET)

b. Regular (between 9:45 am ET and 3:35 pm ET)

c. Closing (after 3:35 pm ET)

d. Within five minutes of a Trading Pause re-open or IPO open

3. Track reasons for entering a Limit State, such as:

a. Liquidity gap –price reverts from a Limit State Quotation and returns to trading within the Price Bands

b. Broken trades

c. Primary Listing Exchange manually declares a Trading Pause pursuant to Section (VII)(2) of the Plan

d. Other

B. Determine (1), (2) and (3) for when a Trading Pause has been declared for an NMS Stock pursuant to the Plan.

II. **Raw Data** *(all Participants, except A-E, which are for the Primary Listing Exchanges only)*

A. Record of every Straddle State.

1. Ticker, date, time entered, time exited, flag for ending with Limit State, flag for ending with manual override.

2. Pipe delimited with field names as first record.

B. Record of every Price Band

1. Ticker, date, time at beginning of Price Band, Upper Price Band, Lower Price Band

2. Pipe delimited with field names as first record

C. Record of every Limit State

1. Ticker, date, time entered, time exited, flag for halt

2. Pipe delimited with field names as first record

D. Record of every Trading Pause or halt

1. Ticker, date, time entered, time exited, type of halt (i.e., regulatory halt, non-regulatory halt, Trading Pause pursuant to the Plan, other)

2. Pipe delimited with field names as first record

E. Data set or orders entered into reopening auctions during halts or Trading Pauses

1. Arrivals, Changes, Cancels, # shares, limit/market, side, Limit State side

2.Pipe delimited with field name as first record

F. Data set of order events received during Limit States

G. Summary data on order flow of arrivals and cancellations for each 15-second period for discrete time periods and sample stocks to be determined by the SEC in subsequent data requests. Must indicate side(s) of Limit State.

1.Market/marketable sell orders arrivals and executions

a. Count

b. Shares

c. Shares executed

2.Market/marketable buy orders arrivals and executions

a. Count

b. Shares

c. Shares executed

3.Count arriving, volume arriving and shares executing in limit sell orders above NBBO mid-point

4.Count arriving, volume arriving and shares executing in limit sell orders at or below NBBO mid-point (non-marketable)

5.Count arriving, volume arriving and shares executing in limit buy orders at or above NBBO mid-point (non-marketable)

6.Count arriving, volume arriving and shares executing in limit buy orders below NBBO mid-point

7.Count and volume arriving of limit sell orders priced at or above NBBO mid-point plus $0.05

8.Count and volume arriving of limit buy orders priced at or below NBBO mid-point minus $0.05

9.Count and volume of (3-8) for cancels

10. Include: ticker, date, time at start, time of Limit State, all data item fields in 1, last sale prior to 15-second period (null if no trades today), range during 15-second period, last trade during 15-second period

III. **[At least two months prior to the end of the Pilot Period,] By September 30, 2014, all Participants shall provide to the SEC assessments relating to the impact of the Plan and calibration of the Percentage Parameters as follows:**

A. Assess the statistical and economic impact on liquidity of approaching Price Bands.

B. Assess the statistical and economic impact of the Price Bands on erroneous trades.

C. Assess the statistical and economic impact of the appropriateness of the Percentage Parameters used for the Price Bands.

D. Assess whether the Limit State is the appropriate length to allow for liquidity replenishment when a Limit State is reached because of a temporary liquidity gap.

E. Evaluate concerns from the options markets regarding the statistical and economic impact of Limit States on liquidity and market quality in the options markets. (Participants that operate options exchange should also prepare such assessment reports.)

F. Assess whether the process for entering a Limit State should be adjusted and whether Straddle States are problematic.

G. Assess whether the process for exiting a Limit State should be adjusted.

H. Assess whether the Trading Pauses are too long or short and whether the reopening procedures should be adjusted.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71656 / March 6, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3786 / March 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15775

In the Matter of **DANIEL BERGIN,** **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 Daniel Bergin ("Respondent").

II.

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

III.

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

1. Bergin was a trader at Cushing MLP Asset Management, LP ("Cushing"), an investment adviser registered with the Commission. Bergin was also a registered representative associated with broker-dealers registered with the Commission. Bergin, 40 years old, is a resident of Dallas, Texas.

2. On July 22, 2013, a partial judgment was entered by consent against Bergin, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 17(j) of the Investment Company Act of 1940 and Rules 17j-1(b)(1), (3), and (4) and 17j-1(d), in the civil action entitled Securities and Exchange Commission v. Daniel Bergin, et al., Civil Action Number 3:13-cv-1940, in the United States District Court for the Northern District of Texas, Dallas Division.

3. The Commission's complaint alleged that from at least 2011 through May 2013, Bergin defrauded Cushing and its clients by using Cushing's confidential trading information to trade on and ahead of hundreds of Cushing's client trades for personal profit. The complaint also alleges that Bergin concealed his trading activity by failing to disclose his trades or the existence of his wife's brokerage accounts, which he used to conduct the trading.

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 203(f) of the Advisers Act that Respondent be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

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. 71658 / March 6, 2014

INVESTMENT ADVISERS ACT 0F 1940
Release No. 3787 / March 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15776

In the Matter of

Michael R. Shechtman,

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 Michael R. Shechtman ("Shechtman" or "Respondent").

II.

In anticipation of the institution of these proceedings, Shechtman 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, Shechtman consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Shechtman, 39, was a registered representative associated with Ameriprise Financial, Inc., a broker-dealer and an investment adviser registered with the Commission, from December 1997 until his resignation in March 2012. Shechtman held Series 7 and 63 licenses during that time.

2. On January 6, 2014, a judgment was entered by consent against Shechtman, permanently enjoining him from future violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder, in the civil action entitled Securities and Exchange Commission v. Michael R. Shechtman, et al., Civil Action Number 13-cv-80954, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that, while associated with Ameriprise, Shechtman received a tip of non-public information about a potential merger from a friend who was an investment adviser firm owner. The complaint further alleged that while in possession of this non-public information, Shechtman traded in the securities of the firm to be acquired for himself and his wife, and made profits of $109,040.53 from this trading.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Shechtman'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 Shechtman be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71667 / March 7, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3788 / March 7, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 30977 / March 7, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15249

In the Matter of CRAIG BERKMAN, d/b/a VENTURES TRUST LLC, JOHN B. KERN, FACE OFF ACQUISITIONS, LLC, FACE OFF MANAGEMENT, LLC, a/k/a FACE OFF ACQUISITIONS MANAGEMENT, LLC, VENTURES TRUST II LLC, VENTURES TRUST III LLC, VENTURES TRUST IV LLC, VENTURES TRUST V LLC, VENTURES TRUST VI LLC, VENTURES TRUST ASSET FUND LLC, VENTURES TRUST MANAGEMENT LLC, VENTURES TRUST ASSET MANAGEMENT, LLC, a/k/a VENTURES TRUST II ASSET MANAGEMENT, LLC, ASSENSUS CAPITAL, LLC AND ASSENSUS CAPITAL MANAGEMENT, LLC, Respondents.	ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS, AND IMPOSING SANCTIONS, PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, AS TO JOHN B. KERN

8 of 63

I.

On March 19, 2013, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Craig Berkman, d/b/a Ventures Trust LLC ("Berkman"), John B. Kern ("Kern" or "Respondent"), Face Off Acquisitions, LLC ("Face Off Acquisitions"), Face Off Management, LLC, a/k/a Face Off Acquisitions Management, LLC ("Face Off Management"), Ventures Trust II LLC ("Ventures II"), Ventures Trust III LLC ("Ventures III"), Ventures Trust IV LLC ("Ventures IV"), Ventures Trust V LLC ("Ventures V"), Ventures Trust VI LLC ("Ventures VI"), Ventures Trust Asset Fund LLC ("Ventures Asset Fund"), Ventures Trust Management LLC, Ventures Trust Asset Management, LLC a/k/a Ventures Trust II Asset Management, LLC (Ventures Trust Management LLC and Ventures Trust Asset Management, LLC are collectively referred to hereinafter as "Ventures Trust Management"), Assensus Capital, LLC ("Assensus Capital"), Assensus Capital Management, LLC ("Assensus Management"). The Commission deems it appropriate and in the public interest that public administrative proceedings also be, and hereby are, instituted against Kern pursuant to Section 4C[1] of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

II.

In response to the institution of these proceedings, and in anticipation of the institution of public administrative proceedings pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, 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

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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 . . . (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)(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.

to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940, and Instituting Public Administrative Proceedings, and Imposing Sanctions, Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, as to John Kern ("Order"), as set forth below:

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

SUMMARY

1. From approximately October 2010 through September 2012, Berkman fraudulently raised at least $13.2 million from approximately 120 investors by selling membership interests in limited liability companies ("LLCs") that Berkman controlled, including Face Off Acquisitions, Assensus Capital and several LLCs with the words "Ventures Trust" in their names.

2. Berkman made material misrepresentations he knew were false to investors in three different sets of offerings. In one set of offerings, Berkman told investors in Ventures II, III, IV, V, and VI (collectively, the "Ventures LLCs") that their funds would be used to acquire highly coveted, pre-initial public offering ("pre-IPO") shares of Facebook, Inc., LinkedIn, Inc., Groupon, Inc., and Zynga Inc. In another offering, Berkman told investors in Face Off Acquisitions that their money would be used either to purchase pre-IPO shares of Facebook or to acquire a company that held pre-IPO Facebook shares. In a third offering, Berkman told investors in Assensus Capital that he would use their money to fund various new, large-scale, technology ventures.

3. Instead of using the investor funds to acquire pre-IPO shares or fund technology ventures, Berkman misappropriated most of the offering proceeds. Berkman used most of the money to make payments to investors in his earlier investment schemes and to some of the victims of this fraud in Ponzi scheme fashion, including approximately $5.43 million to satisfy a prior judgment against him and another $4.8 million to investors who had invested either in this pre-IPO scheme or in other schemes. Berkman also used approximately $1.6 million to fund his own personal expenses, including large cash withdrawals and dining and travel expenses.

4. Of the $13.2 million raised, Berkman used $600,000 to purchase a small interest in an unrelated fund that had acquired pre-IPO Facebook stock. That purchase did not provide any of the Ventures LLCs, or any other company affiliated with Berkman, with ownership of Facebook

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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.

shares. Berkman and/or one of his associates nevertheless used a forged letter about that investment to falsely represent to investors that Ventures II owned nearly half a million shares of Facebook stock. Upon discovering the forgery, the fund informed Berkman and Kern that it was immediately terminating and liquidating the Ventures II interest.

5. To aid and abet the fraud, Kern, a lawyer and general counsel to Ventures II and Face Off Acquisitions, made certain material misstatements to investors and others that he knew or recklessly disregarded were false and misleading.

SETTLING RESPONDENT

6. **Kern**, age 49, resides in Charleston, South Carolina. Kern is an attorney licensed to practice law in South Carolina and also has an office in the Republic of San Marino. During the time of the events described herein, Kern was, among other roles, general counsel to Ventures II and Face Off Acquisitions and associated with the investment advisers to those and other funds. Kern represented Ventures II in the staff's investigation of this matter.

OTHER RESPONDENTS

7. **Berkman**, age 72, is currently incarcerated in the Metropolitan Detention Center in Brooklyn, New York. At all relevant times, Berkman controlled each of the Respondent entities. Berkman has pled guilty to criminal conduct relating to the findings in this Order. Specifically, in *United States v. Craig L. Berkman*, Crim. No. 13-CR-00732 (SAS) (S.D.N.Y.) ("Parallel Criminal Action"), Berkman pleaded guilty to violations of Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)], and wire fraud [18 U.S.C. §1343]. In connection with that guilty plea, Berkman admitted, among other things, that:

(a) From around October 2010 through March 2013, he controlled a series of limited liability companies that solicited money from investors. He told investors that their investments would be used to purchase pre-IPO shares of companies, such as Facebook, LinkedIn, Zynga and others, and they were expected to go public soon;

(b) In the course of soliciting investments, he made false statements of material fact. For example, he knowingly misrepresented the number of Facebook shares his companies controlled; and

(c) He engaged in further fraud and deceit. He used the money invested with his companies for purposes other than purchasing pre-IPO shares of companies, as he had promised investors. For example, he used close to $6 million to pay creditors in a bankruptcy proceeding ("Berkman's Bankruptcy Proceeding").

On December 13, 2013, the Commission issued an Order finding that Berkman willfully violated, and willfully aided and abetted and caused violations of, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

8. **Face Off Acquisitions** is a Delaware LLC formed on May 24, 2011.

9. **Face Off Management** is a Delaware LLC formed on May 24, 2011.

10. **Ventures II** is a Delaware LLC formed on June 15, 2010. Ventures II purported to have offices in Tampa, Florida, Los Angeles, California, and New York, New York. Ventures II purported to be a private equity firm with a "unique opportunity to purchase discounted shares of Facebook." The majority of the investor funds at issue were deposited into Ventures II bank accounts and comingled with investor funds initially deposited into accounts held in the names of the other Ventures LLCs.

11. **Ventures Trust Asset Management** is a Delaware LLC formed on March 7, 2007. Berkman owns or owned 100% of the membership interests of Ventures Trust Asset Management.

12. **Ventures Trust Management** is a Delaware LLC formed on August 8, 2011.

13. **Ventures III** is a Delaware LLC formed on December 28, 2010. Ventures III purported to have offices in Los Angeles, California. It purported to be a private equity firm with a "unique opportunity to purchase discounted shares" and whose "first investment will be made in LinkedIn."

14. **Ventures IV** is a Delaware LLC formed on January 27, 2011. Ventures IV purported to have offices in Los Angeles, California. Ventures IV purported to be a private equity firm with a "unique opportunity to purchase discounted shares," whose "first investment will be made in Groupon." Ventures IV held a bank account through which Berkman funneled investor funds and whose title is "Ventures Trust IV Groupon." Berkman is listed as a signatory on the bank account.

15. **Ventures V** is a Delaware LLC formed on January 27, 2011. It also held a bank account through which Berkman funneled investor funds.

16. **Ventures VI** is a Delaware LLC formed on January 27, 2011. It held a bank account through which Berkman funneled investor funds.

17. **Ventures Trust Asset Fund** is a State of Washington LLC formed on January 11, 2007. A portion of the misappropriated investor funds at issue were transferred to Ventures Trust Asset Fund.

18. **Assensus Capital** is a Delaware LLC formed on July 14, 2011. Assensus Capital purported to have offices in Tampa, Florida and New York, New York. It purported to be a private equity firm focused on "funding affiliated, groundbreaking companies in surgical technology fields and in the forefront of a new generation of nuclear power plant design."

19. **Assensus Management** is a Delaware LLC formed on July 14, 2011. It purported to serve as Assensus Capital's Managing Member and to be "responsible for the sourcing, structuring and oversight of the portfolio investments."

OTHER RELEVANT PERSONS AND ENTITIES

20. **The Manager**, age 49, resides in Encinitas, California. At all relevant times, the Manager managed and provided "day-to-day leadership" for the respective managing members of Face Off Acquisitions, Ventures Trust, and Assensus Capital.

21. **Actual Facebook Funds** are two single-purpose, pooled investment vehicles associated with a registered broker-dealer in New York City. The two Actual Facebook Funds both held pre-IPO Facebook stock during the relevant period.

22. **Actual Facebook Fund 2** is a Delaware LLC (unrelated to the Actual Facebook Funds) formed to acquire pre-IPO securities of Facebook. Actual Facebook Fund 2 held only pre-IPO Facebook stock during the relevant period.

23. **The Law Firm** is a large law firm that served as corporate counsel to the Actual Facebook Funds.

24. **The Broker-Dealer** is a registered broker-dealer in New York City. The Broker-Dealer has not acquired or tried to acquire pre-IPO Facebook securities or interests in pre-IPO Facebook securities or operated single-purpose funds holding Facebook securities.

FACTUAL BACKGROUND

Berkman's Prior Securities Violations and Bankruptcy

25. In 2001, the Oregon Division of Finance and Securities issued a cease-and-desist order against Berkman for offering and selling convertible promissory notes without a brokerage license to Oregon residents between 1983 and 1997. Berkman received a $50,000 fine.

26. In June 2008, an Oregon jury found Berkman liable in a private action for breach of fiduciary duty, conversion of investor funds, and misrepresentation to investors, among other things, arising from Berkman's involvement with a series of purported venture capital funds known as Synectic Ventures (collectively "Synectic"). Berkman's improper use of Synectic funds included more than $5 million in purported "personal loans" and the misuse of investor funds to cover personal expenses and execute personal stock purchases. The court entered a $28 million judgment against Berkman ("2008 Oregon Judgment").

27. In March 2009, Synectic filed an involuntary Chapter 7 bankruptcy petition against Berkman in the Middle District of Florida alleging that he owed more than $15.4 million in unpaid debts arising from the 2008 Oregon Judgment. On August 11, 2010, the court entered three

judgments against Berkman totaling nearly $15 million, plus 9% interest and costs, deemed non-dischargeable in bankruptcy.

28. The parties to the bankruptcy proceeding then reached a settlement in which Berkman was required to pay $4.75 million in seven installments, beginning on November 30, 2010. After making the first four payments, totaling $1.5 million, Berkman failed to make the fifth payment, due on March 17, 2011. He defaulted on several subsequent revised payment schedules, which also included 5% annual interest. The Chapter 7 Trustee recommenced adversary proceedings, leading to a further revised settlement agreement with a final payment date of May 11, 2012. On May 9, 2012, Berkman paid the remaining balance of more than $3.2 million and the pending adversary proceedings against him were dismissed with prejudice.

29. As detailed below, Berkman used a substantial part of the proceeds of his pre-IPO offering fraud (and none of his own money) to pay the Florida bankruptcy claims.

The Ventures Fraud

30. From approximately October 2010 through February 2012, Berkman and the Manager made numerous misrepresentations to Ventures LLC investors when offering and selling membership interests in the various Ventures LLCs, both orally and in writing, including in the formal offering documents.

31. Berkman and the Manager falsely told investors that each of the Ventures LLCs would use their funds to acquire highly coveted, pre-IPO shares in one or more social media companies that were planning IPOs at the time, including Facebook, LinkedIn, Groupon or Zynga. For example, Berkman and the Manager falsely told certain investors that Ventures II was going to purchase pre-IPO Facebook shares and falsely told other investors that Ventures II had already purchased such shares.

32. Berkman and the Manager sent prospective investors offering documents that contained a host of materially false statements.

33. Berkman and the Manager provided investors with at least three different versions of a private placement memorandum ("Memorandum") for Ventures II and other formal offering materials, all of which contained false statements about acquiring Facebook shares. For example, Berkman provided a February 2012 Ventures II Memorandum to at least one potential investor, and the Manager provided Memoranda dated November 2010 and September 2011 to other investors. These Memoranda all represent that "investment proceeds will be used to purchase Facebook shares" and that "Facebook shares will be purchased" at various prices per share.

34. Berkman and the Manager also provided investors with the Ventures II operating agreement, which states that "the purpose of the Company is to acquire Facebook stock." Both Berkman and the Manager signed Ventures LLC membership certificates falsely stating that the investor is a "registered holder of one unit invested in Facebook." The Manager provided these certificates to investors.

35. Berkman signed letters to Ventures II investors acknowledging receipt of their investment proceeds and falsely stating, among other things, that the "investment was used to purchase . . . shares of Facebook stock at a cost basis of [a certain amount] per share." In addition, Berkman signed Ventures II "Quarterly Reports" and a "Letter of Ownership," which the Manager provided to investors, falsely stating that their Ventures II investment purchased a specific number of shares of pre-IPO Facebook shares at a specific price. The Manager further provided investors with a Ventures II "Facebook Opportunity Fund Overview," which falsely stated that their "investment is solely allocated to the purchase of Facebook stock."

36. Berkman also lied to Ventures II investors about the annual interest rate they would receive. The Ventures II Memoranda and other documents represented that members "will receive a 5% annual simple interest return on the investment until 100% of their principal and accumulated interest has been returned." Berkman signed a quarterly report falsely stating that the value of the investment had increased, apparently due to the 5% annual interest. Berkman had the Manager give the quarterly report to Ventures II investors.

37. Berkman knew all of these statements were false, because he knew that none of the Ventures LLCs owned pre-IPO Facebook, LinkedIn, Groupon or Zynga shares and because he was personally misappropriating the investors' funds.

38. In late 2010, Ventures II used $600,000 of investor funds to acquire an interest in the Actual Facebook Funds. This acquisition did not entitle Ventures II to the ownership of Facebook shares owned by the Actual Facebook Funds, but it did entitle Ventures II to an approximately 3.19% interest in the Actual Facebook Funds. At most, Ventures II's $600,000 interest in the Actual Facebook Funds represented an indirect interest equivalent to approximately 22,253 shares of Facebook.

39. In September 2011, Kern asked the Law Firm, counsel to the Actual Facebook Funds, for a letter on the firm's letterhead describing Ventures II's interest in the Actual Facebook Funds and Facebook. In response, an associate at the Law Firm sent a letter with his signature to a purported Ventures II office in Manhattan at an address Kern provided. The letter, dated October 19, 2011, was addressed to Berkman and the Manager. The letter accurately stated that Ventures II held a 3.1899% interest in the Actual Facebook Funds and that the Actual Facebook Funds held an unspecified amount of Facebook shares. The letter did not state that Ventures II actually owned any Facebook shares.

40. The letter was subsequently altered with Berkman's participation, knowledge and consent. The altered version was dated February 22, 2012. It was printed on the Law Firm's letterhead and had a forged version of the Law Firm associate's signature on it. The letter falsely represented that the Actual Facebook Funds "ha[ve] allocated 497,625 shares of Facebook, Inc. in Ventures Trust II LLC['s] capital account."

41. In or prior to February 2012, a prospective investor, who happened to be a securities attorney, asked the Manager for some assurance that Ventures II had acquired the pre-

IPO Facebook shares that the Manager had claimed it acquired. In approximately February 2012, the Manager showed the forged letter to the investor, who then invested $108,000 in Ventures II. The Manager refused to let the investor retain a copy of the letter.

42. On February 27, 2012, the Manager sent an email to another prospective investor with a copy of the forged letter attached.

43. On March 1, 2012, the Law Firm wrote a letter addressed to Berkman and the Manager. The letter enclosed a copy of the forged letter and stated that the forged letter "constitutes a fraudulent misrepresentation of your participation and interest in" the Actual Facebook Funds, "since your investment represents only 22,253 shares of Facebook, Inc. stock." The letter continued: "[The forged letter] was not drafted, executed or distributed by this law firm, is an unlawful and unauthorized use of this law firm's name and letterhead and contains a forged signature of an attorney at this law firm." The letter further informed Berkman and the Manager that "[y]our misconduct is consistent with a general pattern of deceit" and therefore that Ventures II's interest in the Actual Facebook Funds "is hereby terminated effective as of the dates of your initial investments."

44. On March 9, 2012, Kern, "as counsel to Ventures [II]," wrote back to the Law Firm. Kern's letter claimed that Ventures II "is the victim of some other party's fabrication of the letter" and "we do not know the source of that letter." Kern's letter took issue with the termination of "important legal and economic rights of Ventures [II]" and threatened to file an NASD complaint.

45. A partner at the Law Firm stated that, on approximately March 12, 2012, he advised Kern by telephone that Ventures II's $600,000 interest in the Actual Facebook Funds had been rescinded and that the proceeds would be held in a segregated account to satisfy potential future claims. Kern and the Law Firm partner corresponded concerning a potential resolution of the matter in the days thereafter.

46. Despite Kern's threat of legal action, neither Kern nor anyone else associated with Ventures II took legal action against the Actual Facebook Funds. Subsequently, the Actual Facebook Funds transferred Ventures II's interest to another investor and placed the cash proceeds in a segregated account held by the Actual Facebook Funds, where these assets remain.

47. In total, Berkman and the Manager raised more than $9.9 million from all the Ventures LLC investors. Of that amount, approximately $6.56 million was deposited in various Ventures II bank accounts, purportedly to be used to acquire pre-IPO Facebook shares; approximately $1.68 million was deposited in a Ventures III account, purportedly to be used to acquire pre-IPO LinkedIn shares; approximately $624,000 was deposited in a Ventures IV account, purportedly to be used to acquire pre-IPO Groupon shares; and approximately $1.07 million was deposited in a Ventures VI account, purportedly to be used to acquire pre-IPO Zynga shares.

48. Other than $600,000 that was used to purchase an interest in the Actual Facebook Funds that was subsequently terminated, none of the Ventures LLCs' investor funds were ever

used to purchase pre-IPO shares of Facebook, LinkedIn, Groupon, Zynga, or any other company, as Berkman knew.

49. In May 2011, a bankruptcy attorney involved in Berkman's Bankruptcy Proceeding spoke with Kern about Berkman's sources of income and the sources of funds Berkman used to make payments in the bankruptcy proceeding, and the bankruptcy attorney subsequently sent Kern a letter memorializing and verifying certain factual representations that Kern had made to her. In the letter, the bankruptcy attorney advised Kern that Berkman was in default of his bankruptcy obligations, and that there was a concern that Berkman might be using investor proceeds received by funds managed by Ventures Trust Management to satisfy his bankruptcy obligations. The bankruptcy attorney advised Kern that the bankruptcy involved twenty adversarial proceedings to recover fraudulent transfers involving Berkman within the last five years.

50. The bankruptcy attorney stated in her May 20, 2011 letter to Kern that "you were very clear that none of the funds use[d] to pay any of the [consulting] fees delivered to Mr. Berkman are derived from investors in Ventures Trust Management LLC projects or from projects of funds that are managed by Ventures Trust Management LLC for the benefit of third parties." The letter states if "this letter sets forth our conversation accurately, I would appreciate you so indicating by signing and dating the enclosed copy of this letter." On May 23, 2011, Kern signed the enclosed copy of the letter, confirming that "I have read the foregoing and it is factually correct."

51. Kern's representations in the copy of the letter that he signed on May 23, 2011 were false. By May 2011, approximately $525,000 had been transferred from a bank account held by Ventures II, which was managed by Ventures Trust Management and Berkman, to pay claims owed by Berkman in Berkman's Bankruptcy Proceeding. Kern knew, or was reckless in not knowing, that Berkman had used investor proceeds to satisfy his bankruptcy obligations. By falsely assuring the bankruptcy attorney that Berkman was not using investor funds to pay his bankruptcy obligations, Kern substantially assisted Berkman's ongoing scheme. Kern's misrepresentations facilitated the scheme by enabling Berkman to continue to misuse investor money to pay, among other things, his bankruptcy obligations and other personal expenses, and to make payments to Kern. Beginning in May 2011, Kern received a total of $234,577 from Ventures LLC accounts into which investor funds obtained through Berkman's scheme were deposited.

The Face Off Acquisition Fraud

52. From approximately 2011 through July 2012, while he was conducting the Ventures fraud, Berkman fraudulently raised approximately $2.6 million by selling membership interests in Face Off Acquisitions.

53. Actual Facebook Fund 2 owned a significant amount of pre-IPO Facebook shares.

54. Berkman told prospective investors over the telephone and in face-to-face meetings that Face Off Acquisitions would use its investor funds to acquire Actual Facebook Fund 2 or would otherwise acquire pre-IPO Facebook shares.

55. Berkman's effort to acquire Actual Facebook Fund 2 was perfunctory, at best. Berkman approached Actual Facebook Fund 2 about a proposal to purchase it, and Actual Facebook Fund 2's manager told Berkman in approximately April 2011 that it would cost at least $28 million. Because Berkman and his entities never had the money, a deal was never likely or imminent.

56. Yet Berkman portrayed the Actual Facebook Fund 2 deal as imminent to prospective investors.

57. A letter dated April 14, 2012 on Kern's letterhead described the status of negotiations between Face Off Acquisitions and Actual Facebook Fund 2 and falsely implied that Face Off Acquisitions' purchase of Actual Facebook Fund 2 was likely and imminent. The letter is captioned "Memorandum of Understanding for Investors in Face Off Acquisitions, LLC to acquire [Actual Facebook Fund 2] (1,012,500 shares of Facebook)." The letter stated:

• "I am writing to confirm that yesterday afternoon I spoke with . . . legal counsel for [Actual Facebook Fund 2]. . . and the Company's Managing Director . . . about the prospect for a timely acquisition of the Company by Face Off Acquisitions;"

• "The purpose of this letter is to provide direction for completing [Face Off Acquisitions'] purchase of [Actual Facebook Fund 2]."

• "[Counsel for [Actual Facebook Fund 2] confirms that under the right set of circumstances, [Actual Facebook Fund 2] is willing to enter into a transaction in the coming few days with Face Off Acquisitions."

• "[T]he sole assets of [Actual Facebook Fund 2] are 1,012,500 shares of Class B Common shares of Facebook, Inc."

• "With proof of funds, a summary Term Sheet will be prepared and we will immediately set upon organizing a 'Securities Transaction Agreement' for the purchase and sale of the ownership interests of [Actual Facebook Fund 2]. Because the Facebook IPO is expected to be effective in early May[,] the [Actual Facebook Fund 2] purchase must occur on or before April 24, 2012."

58. Berkman knew the letter was misleading. The seemingly urgent negotiations were a charade, because Berkman knew Face Off Acquisitions could not possibly pay $28 million (or any amount even close to $28 million) to purchase Actual Facebook Fund 2.

59. In approximately April 2012, Berkman provided the letter on Kern's letterhead to at least one prospective investor.

60. Berkman also provided at least one other Face Off Acquisitions investor with an Actual Facebook Fund 2 Memorandum and Actual Facebook Fund 2's due diligence materials to lend the purported acquisition the appearance of legitimacy.

61. In an email on May 15, 2012, Berkman told another Face Off Acquisitions investor that Berkman was "[i]n NY for the closing. We have agreed on a $35.00 per [s]hare price. Will check in with you when the deal is done." In fact, as Berkman knew, there was no closing, no agreement on a share price, and no money to close any such deal.

62. Berkman also provided prospective investors with Face Off Acquisitions Memoranda and other formal offering materials that contained false statements regarding the use of investor funds to purchase pre-IPO Facebook shares or to purchase Actual Facebook Fund 2.

63. Berkman sent at least one investor an April 2012 Face Off Acquisitions Memorandum stating that "Face Off Acquisitions is focused on generating above average financial returns by purchasing up to 1,012,500 pre IPO Facebook common shares, and significant preferred shareholder interest in five proprietary medical technology, capacitor, and water treatment companies."

64. Berkman sent at least one other investor a May 2012 Face Off Acquisitions Memorandum stating that "investment proceeds will be used solely to acquire up to 1,012,500 pre IPO Facebook shares at a $35.00 per share cost basis," and described the "use of proceeds [as] one hundred percent invested in pre Facebook IPO stock."

65. In addition to the Memoranda, Berkman provided investors with other documents that contained similar misrepresentations, including:

• A Face Off Acquisitions operating agreement, which claimed that Face Off Acquisitions "has been formed to acquire, hold and/or dispose of all the issued and outstanding limited liability interests in [Actual Facebook Fund 2];"
• A Face Off Acquisitions memorandum dated April 11, 2012, which thanks the investor for his "willingness to review the Face Off Acquisitions investment opportunity to acquire 1,012,500 series B common pre IPO Facebook shares;" and
• A letter dated May 8, 2012, in which Berkman acknowledges receipt of a $250,000 investment and tells the investor that it was "for the purpose of purchasing seven thousand one hundred forty two Facebook Series B common Rule 144 shares at a cost basis of $35.00 per share."

66. Berkman knew that each of the foregoing statements in the offering documents was false and misleading, because he intended to and did misappropriate all the funds invested in Face Off Acquisitions.

The Assensus Capital Fraud

67. After Facebook's IPO on May 18, 2012, Berkman shifted gears and began focusing on another phony investment vehicle called Assensus Capital. Berkman made similar misrepresentations to prospective investors in Assensus Capital: The investors' money would be invested in some new cutting edge venture, when Berkman was in fact misappropriating the offering proceeds.

68. Berkman sent one investor a June 2012 Assensus Capital Memorandum that stated: "Investment proceeds will be used to acquire significant equity interest in unique enterprises that serve large and growing markets, with superior profit margins [through] investing in state-of-the-art medical devise, infrastructure (water), distressed debt, and advanced nanotechnology materials companies."

69. Berkman also wrote memoranda to prospective Assensus Capital investors that named specific companies in which Assensus Capital would invest and extended an investment "guaranty" purportedly backed up by cash or shares from one of its "portfolio" companies, including Facebook.

70. One such memorandum to a prospective investor, dated August 27, 2012, stated: "Upon making [an] Assensus Capital LLC investment, you will receive a 5% simple interest from the date of your investment, which will be returned together with your principal investment [in cash] or the equivalent in Facebook shares." That investor later invested approximately $150,000.

71. Afterwards, Berkman tried to solicit another investment from the same investor by again offering a "guaranty" linked to Facebook stock, this time making the following representations about the nature and basis for the guaranty:

- "Assensus Capital LLC and Face Off Acquisitions LLC will obtain the removal of all Facebook share legends upon the expiration of the Facebook November lock-up period in order to allow all or a portion of the shares to be sold as soon as allowed after the expiration date;"

- "Assensus Capital is willing to provide this guaranty for two specific reasons: (1) a high degree of confidence that [a target company] will be acquired within the next 6-12 months; and (2) the value of my carried interest in previous investment activities relating to the acquisition of Facebook shares, that is represented by share certificates for 165,713,000 common shares that I am holding as part of my compensation;" and

- "If you decide to exercise the investment guaranty, you can elect to receive the amount of your prospective investment together with the accumulated five percent annual simple interest or, a partial or complete distribution of 6,500 [Facebook] shares in addition to the 51,666 Facebook shares that are in your capital account as the result of your initial $150,000 [investment] with a cost basis of $7.74 per share."

72. As Berkman knew, each of these representations was false. He intended to and did misappropriate all of the funds invested in Assensus Capital and knew neither he nor Assensus Capital had Facebook shares with which to guaranty investments.

73. Despite Berkman's assurances, the investor declined to invest additional funds.

74. In total, Berkman raised approximately $718,000 from Assensus Capital investors.

The Misappropriation of Investor Funds

75. None of the statements made by Berkman about the use of the funds invested in the Venture LLCs, Face Off Acquisitions, or Assensus Capital were true. Other than the $600,000 investment in the Actual Facebook Funds, none of the offering proceeds were used to make any investments at all, much less the purchase of pre-IPO shares in Facebook, LinkedIn, Groupon or Zynga.

76. Berkman personally transferred approximately $5.1 million of investor funds to his personal bank account. Berkman used most of that $5.1 million, plus a $925,000 direct transfer from a Ventures LLC account, to pay his judgment creditors in the bankruptcy proceeding.

77. Berkman used the remaining money that he had transferred to his personal account (approximately $600,000) and another approximately $1 million taken directly from the Ventures LLC accounts to make large cash withdrawals, pay legal fees, fund his own travel and other personal expenses and make numerous other payments unrelated to the purported business of the Ventures LLCs, Face Off Acquisitions or Assensus Capital. For example, Berkman spent approximately $300,000 on dining, travel, retail and healthcare expenses and withdrew at least another $165,000 in cash or cash equivalents.

78. The Manager received approximately $502,000 from accounts into which investor funds were deposited.

79. As detailed above, Kern received $234,577 in legal fees and expenses during the relevant period from Ventures LLC accounts into which investor funds were deposited.

80. The majority of the rest of the offering proceeds, approximately $4.8 million, was used to make payments to earlier investors in the pre-IPO scheme or, in some cases, to investors in Berkman's prior investment schemes. For example, in 2010 and 2011, Berkman transferred $400,000 from a Ventures LLC account to two individuals to whom Berkman owed money from investments they had made in unrelated Berkman ventures in approximately 2004.

Misrepresentations To Conceal The Scheme

81. As the end of the lock up period for pre-IPO Facebook stock approached and investors began making requests for their distributions, the fraud began to unravel. In response, Berkman, Kern, and others knowingly or recklessly made, or caused to be made,

misrepresentations to investors to keep them from learning of the fraud and demanding the return of their funds.

82. For example, in August 2012, Kern wrote and signed a "Memorandum to Investors About Ventures Trust II LLC Efforts to Secure and Protect Interests with Our Trading Counterparties." Kern's memorandum stated that he was writing "to advise [investors] on the status of our efforts to address concerns that have been raised about the integrity of the funds."

83. Kern's memorandum represented that "Ventures Trust II has utilized two separate counterparties in securing the investments in privately held Facebook stock," and that "we are in the process of attempting to secure the transfer of these shares to our own trading account in order to avoid any complications arising out of the counterparty's trading practices."

84. Kern's memorandum represented that with respect to the first counterparty, "which involves approximately 20% of the investment capital of Ventures Trust II in Facebook stock," the counterparty "and its counsel have repeatedly affirmed that it has the requisite shares and reconfirmed to us that we have the securities interests to which we subscribed." The memorandum then suggested that the counterparty may have "more-or-less fabricated" the price of the shares, creating a "collateral issue," but assured investors that Ventures II would "address this in due course on behalf of our investors," if necessary.

85. Kern's memorandum further represented that the second counterparty "holds approximately 80% of our investments in Facebook."

86. The memorandum also stated that Ventures II "is subject to non-disclosure agreements with [both] counterparties which prevent us from disclosing the identity of these New York based groups at this time" and that Ventures II "is not a Ponzi scheme and absolutely and affirmatively rejects this assertion as false and malicious."

87. As Kern knew or at least recklessly disregarded, his statements were false. The Actual Facebook Funds were the first counterparty described in Kern's memorandum. As set forth above, Kern had learned five months earlier that the Actual Facebook Funds had stated that they would terminate and liquidate Ventures II's interest in the Actual Facebook Funds based on the forged letter. Kern's memorandum did not disclose those material facts and he knew, or recklessly disregarded, that his representations about the first counterparty were therefore false and misleading. The Broker-Dealer was the second counterparty described in Kern's memorandum. The Broker-Dealer never received an investment from, or engaged in any transactions with, Ventures II or any other entity associated with Berkman. Had Kern contacted the Broker-Dealer or conducted even the most cursory inquiry, he would have known for certain that this representation was false. In fact, contrary to Kern's representation, no non-disclosure agreement existed between the Broker-Dealer and Ventures II (or any of the other respondent entities).

88. In August 2012, the Manager emailed Kern's memorandum to certain investors, with a copy to Berkman. Berkman thereafter told investors that he had decided to liquidate the fund investments and that the funds would soon start making distributions. As Berkman knew,

such statements were false and, as recently as in or around March 2013, Berkman gave investors a series of false excuses for why the distributions were still being delayed.

VIOLATIONS

89. As a result of the conduct described above, Kern willfully aided and abetted, and caused, violations committed by Berkman, Ventures Trust Management and the Manager of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8, which prohibit certain fraudulent conduct by an investment adviser.

IV.

Pursuant to this Order, in settlement of this matter, Respondent agrees that disgorgement of $234,577, plus pre-judgment interest of $8,920, and a third tier civil penalty of $100,000 are appropriate, and he further agrees to additional proceedings herein for the sole purpose of determining whether Respondent shall be ordered to pay all of the foregoing amounts in full based on such evidence as Respondent may present pursuant to Rule 630 of the SEC Rules of Practice regarding his claimed inability to pay all such amounts in full. The hearing officer shall make such determination at a hearing and in connection with such hearing and any additional proceedings herein: (a) Respondent agrees that he will be precluded from arguing that he did not engage in the conduct, and is not liable for the violations of the federal securities laws, described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order or the disgorgement, prejudgment interest or civil monetary penalty amounts set forth above; (c) solely for the purposes of such hearing and any additional proceedings herein, the findings in the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may, in addition to hearing live testimony, determine the issue raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

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, and to institute additional proceedings to determine the question set forth in Section IV hereof.

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act, Section 9(b) of the Investment Company Act, Section 4C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, it is hereby ORDERED, effective immediately, that:

A. Respondent Kern shall cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

B. Respondent Kern shall be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; 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.

C. Any reapplication for association by Respondent Kern 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. As set forth in Section IV hereof, Respondent Kern shall pay disgorgement of $234,577, plus pre-judgment interest of $8,920, and a third tier civil penalty of $100,000 subject to a determination, pursuant to the additional proceedings set forth in this order, with respect to Kern's claimed financial inability to pay all such amounts in full.

E. Respondent Kern is denied the privilege of appearing or practicing before the Commission as an attorney.

VI.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section IV hereof shall be convened at a time and place to be fixed by Administrative Law Judge Carol Fox Foelak, who had been designated by prior Order.

If Respondent fails to appear at a hearing after being duly notified, 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 Rule 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 via email or such other means as the Rules of Practice may provide.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision concerning the questions set forth in Section IV hereof 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.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 9555/ March 7, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71664 / March 7, 2014

Admin. Proc. File No. 3-13927

In the Matter of

GORDON BRENT PIERCE
c/o William F. Alderman
Shireen Qaru
Orrick, Herrington & Sutcliffe LLP
405 Howard Street
San Francisco, CA 94105

OPINION OF THE COMMISSION

SECURITIES ACT PROCEEDING

Grounds for Remedial Action

Sale of Unregistered Securities

Individual found in an earlier proceeding to have violated §§ 5(a) and 5(c) of the Securities Act of 1933 by offering to sell and selling unregistered securities from a personal account contended that res judicata, equitable estoppel, judicial estoppel, and waiver barred a second proceeding charging him with having violated those same sections by offering to sell and selling unregistered securities from corporate accounts. *Held*, the asserted defenses did not preclude the bringing of a second proceeding, and the record supports a finding that respondent committed the violations charged.

APPEARANCES:

William F. Alderman, Shireen Qaru, Russell D. Duncan, and *Justin Bagdady*, of Orrick Herrington & Sutcliffe, LLP, and *Christopher B. Wells* and *David C. Spellman*, of Lane Powell PC, for Gordon Brent Pierce.

Marc J. Fagel, Michael S. Dicke, John S. Yun, Judith L. Anderson, and *Steven D. Buchholz*, for the Division of Enforcement.

Appeal filed: August 17, 2011
Last brief received: November 10, 2011
Oral argument: October 8, 2013

I.

Gordon Brent Pierce appeals an administrative law judge's decision. The law judge found, on summary disposition, that Pierce violated §§ 5(a) and 5(c) of the Securities Act of 1933 in connection with unregistered offerings and sales of stock of Lexington Resources, Inc. ("Lexington") through accounts in the names of two offshore companies he controlled. The law judge further ordered Pierce to disgorge ill-gotten gains of $7,247,635.75, plus prejudgment interest.

The law judge found that res judicata ordinarily would have precluded the bringing of this proceeding (the "Second Proceeding") against Pierce, who was previously found to have traded unregistered shares of Lexington in a personal account. But the law judge found that this proceeding could nonetheless go forward because Pierce had concealed evidence that would have enabled the Division of Enforcement to have included the charges of unregistered sales through the corporate accounts in the earlier proceeding (the "First Proceeding"). Based on facts established in the First Proceeding and facts admitted by Pierce, the law judge entered the findings and order described above. The Division cross-appeals, asking us to find that even absent Pierce's concealment of the evidence in question, res judicata would not have precluded bringing the Second Proceeding against him. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

A. Lexington Resources, Inc. was created in 2003 and liquidated in 2008.

Both the First Proceeding and the Second Proceeding concern the unregistered distribution of Lexington stock.[1] The background facts are largely undisputed, either because they were found by the law judge in the First Proceeding or because Pierce admits them.

Lexington came into being in 2003 as the result of a reverse merger between a Nevada corporation named Intergold, Inc. ("Intergold") and Lexington Oil & Gas LLC, an Oklahoma limited liability company ("Lexington Oil & Gas"). Lexington issued three million restricted common shares to Lexington Oil & Gas's shareholders, and its stock began trading on the over-the-counter market on November 20, 2003.

Lexington billed itself as being "engaged in the acquisition and development of oil and gas properties in the United States." The company had no full-time employees; its day-to-day

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1 The First Proceeding also concerned Pierce's failure to make certain reports about his ownership of Lexington shares.

operations were carried out by Grant Atkins, its Chief Executive Officer, and Douglas Humphries, a director.[2] Consultants performed other necessary functions. Lexington employed the consulting firm International Market Trend ("IMT") to provide administrative and other services. Lexington did not have its own offices, but was managed out of IMT's offices in Blaine, Washington. During 2003 and 2004, Lexington held no shareholder meetings, nor did its board of directors meet on a regular basis. Important matters were resolved by consent resolution.

Lexington filed a Chapter 11 bankruptcy petition on March 4, 2008. The petition was converted to Chapter 7 liquidation on April 22, 2008.

B. Pierce received Lexington shares and sold them in unregistered transactions.

Between 2002 and 2007, Pierce, a Canadian citizen residing in British Columbia, provided Intergold and Lexington with stock promotion, capital raising, and other services through various consulting firms.[3] Intergold and Lexington, in turn, compensated Pierce's companies for their services with stock or stock options. The consulting companies then allocated shares to Pierce and others. Pierce ultimately controlled Lexington through his ownership of Lexington stock, together with his influence over Atkins and his control over consultants assigned to work for Lexington, among other things.[4]

In allocating shares, the consulting companies purposely structured allocations so that Pierce would not exceed the ten percent beneficial ownership threshold that would require reporting under § 16 of the Exchange Act.[5] On Pierce's instructions, many of the shares so

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2 Atkins and Lexington were charged in the First Proceeding with violations of Securities Act §§ 5(a) and 5(c). The First Proceeding concluded as to them on November 26, 2008. *See Lexington Res., Inc.*, Securities Act Release No. 8987 (Nov. 26, 2008) (finding that Lexington and Atkins violated Securities Act §§ 5(a) and 5(c) and ordering them to cease and desist from committing or causing any violations or future violations of those provisions).

3 Pierce was sanctioned by the British Columbia Securities Commission ("BSSC") in 1993 for conduct involving improper payments by a publicly traded British Columbia company to an entity of which Pierce was a control person. During the BSSC's investigation, Pierce provided documents that were not genuine. The BSSC barred him for fifteen years from using certain exemptions available under the British Columbia Securities Act and from serving as an officer or director of any reporting issuer or any issuer that provides management, administrative, promotional, or consulting services to a reporting issuer. It also fined Pierce $15,000.

4 When Pierce gave investigative testimony to the Division in 2006, he was serving as an officer or director of IMT and at least five other firms.

5 15 U.S.C. § 78p. Section 16 requires beneficial owners of more than ten percent of certain equity securities to file with the Commission initial statements disclosing the amount of all equity securities of the issuer they beneficially own as well as follow-on statements disclosing changes in such ownership.

allocated were subsequently issued to two corporations: Newport Capital Corporation ("Newport"), a privately held company organized under the laws of Belize of which Pierce formerly served as president and a director, and Jenirob Company Ltd. ("Jenirob"), a privately held company organized under the laws of the British Virgin Islands. On Pierce's further instructions, some shares assigned to Newport were thereafter issued to individuals. No registration statements were filed relating to any resales of Lexington stock by Pierce, Newport, or Jenirob.

In 2003, Pierce opened a personal brokerage account (the "Personal Account") at Hypo-Alpe Adria Bank of Liechtenstein ("Hypo Bank"). Hypo Bank, in turn, opened an omnibus account (the "Hypo Omnibus Account") at vFinance Investments, Inc., a U.S. broker-dealer ("vFinance"). Newport and Jenirob also had brokerage accounts with Hypo Bank (respectively, the "Newport Account" and the "Jenirob Account"; together, the "Corporate Accounts"). Pierce was the beneficial owner of the assets in the Corporate Accounts. Through the Hypo Omnibus Account, Hypo Bank could trade securities for any of these customers without disclosing the identity of the owner of the securities in any particular trade.

In late February 2004, Pierce and an associate began actively promoting Lexington by sending millions of spam e-mails and newsletters through a publishing company Pierce controlled. At the same time, Lexington issued a flurry of optimistic press releases about its current and potential operations. During this promotional campaign, Pierce personally met with potential Lexington investors and distributed folders containing promotional materials and press releases. From February to June 2004, Lexington's stock price increased from $3.00 to $7.50, and Lexington's average trading volume increased from 1,000 to about 100,000 shares per day. Trading volume reached a peak of more than one million shares per day in late June 2004.

As of April 30, 2004, Pierce held a total of 446,683 Lexington shares in the Personal Account. The majority of these shares, 325,000 in all (the "Option Shares"), had been issued pursuant to a Stock Option Plan that provided for common share options to be issued to officers, directors, employees, and consultants to whom Lexington owed money. The recipients of these options were allowed to use the debt that Lexington owed them to cover their exercise price. When consultants exercised the options, they were required to represent to Lexington that "all Option Shares shall be acquired solely . . . for investment purposes only and with no view to their resale or other distribution of any kind." Lexington had filed a "Form S-8 for Registration Under the Securities Act of 1933 for Securities to be Offered to Employees Pursuant to Employee Benefit Plan," registering one million shares of Lexington common stock. The Form S-8 did not contain a reoffering prospectus. Pierce sold the 121,683 non-Option Shares in the Personal Account between May 2004 and June 24, 2004. He sold the 325,000 Option Shares between June 2004 and September 2004. His total profit from the sales of the Option Shares was $2,043,362.33.[6]

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6 The proceeds from the sales of the non-Option shares were not at issue in the First Proceeding. *See infra* note 13.

As of February 2, 2004, Newport held 1,935,589 shares of Lexington stock. In May 2004, 435,000 Lexington shares were issued to Jenirob. Pierce sold approximately 1.6 million Lexington shares from the Corporate Accounts, through the Hypo Omnibus Account at vFinance, between February 2004 and December 2004. The Division calculated the profits from these sales to be $7,247,635.75.

Pierce had been a five-percent beneficial owner of Intergold before it merged with Lexington Oil & Gas, and he became a beneficial owner of more than five percent of Lexington's stock in November 2003. But he did not, as required, file a Form 13D reporting the five percent interest with the Commission until July 2006, nor did he file forms updating his status as he sold his Lexington stock.[7] Moreover, during at least the period between November 23, 2003 and January 26, 2004, Pierce was a beneficial owner of more than ten percent of Lexington's stock. But he did not file an initial report of that ownership with the Commission. Nor did he report that he held more than ten percent of Lexington's outstanding stock on December 31, 2003, or that he acquired more than one percent of Lexington's outstanding stock on January 26, 2004.[8]

C. The Division conducted an investigation.

The Division began its investigation into trading in Lexington stock on May 4, 2006. During sworn testimony taken by the Division in July 2006, Pierce stated that he had no ownership stake of any kind, either directly or through other entities, in Newport. Pierce further stated that he had "an interest" in the Newport Account, but he denied that he had any such interest in the Jenirob Account. When asked whether he had traded Lexington securities in any brokerage accounts for any individuals or entities other than five enumerated entities (which included Newport but did not include Jenirob), Pierce answered that he had not, effectively denying that he had traded Lexington securities for Jenirob.

The Division's investigative subpoena required Pierce to produce, among other things, "[a]ll DOCUMENTS reflecting or relating to . . . transactions by YOU" in Lexington stock. "YOU" was defined to include "any person or entity acting on [Pierce's] behalf." In response, Pierce did not produce any records reflecting the trading of Lexington stock through the Corporate

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7 Section 13(d) of the Exchange Act, 15 U.S.C. § 78m(d), requires (with certain exceptions not applicable here) any person who becomes, directly or indirectly, the beneficial owner of more than five percent of any class of equity securities registered under the Exchange Act to file a statement with the Commission within ten days of becoming such an owner, and to file another statement if material changes occur in the facts set forth in the prior filing. Rules promulgated under § 13(d) generally require that statements be made on a Schedule 13D.

8 Exchange Act Rule 16a-3, 17 C.F.R. § 240.16a-3, requires that initial statements of beneficial ownership of securities required by Exchange Act § 16(a) be filed on Form 3, that statements of changes in beneficial ownership required by that section be filed on Form 4, and that annual statements be filed on Form 5. Pierce filed none of these.

Accounts.[9] But he did produce a Schedule 13D, which he characterized as "a new Schedule 13D report of the trading in Lexington stock by persons/entities described in this request." The Schedule 13D stated that Pierce and Newport were beneficial owners of Lexington shares in 2003 and 2004, but it did not reflect that Jenirob owned any Lexington shares during this time. Although the Schedule 13D showed some sales of Lexington shares by Newport, it did not reflect trading activity in Lexington shares through the Newport Account.

In late 2006, the Division asked the securities regulator in Liechtenstein, the Finanzmarktaufsicht (the "FMA"), for records of Hypo Bank that would identify, among other things, the customers for which Hypo Bank was selling Lexington stock.[10] The FMA informed the Division that it could not obtain the requested documents for the Division. But in late 2007, the Division learned that the FMA was working to amend Liechtenstein law to provide the FMA additional powers that could potentially allow it to obtain documents for the Division. The Division therefore sent the FMA an additional request for documents on February 20, 2008.

D. The Commission issued an Order Instituting Proceedings, and a hearing was held as efforts to obtain documents continued.

The Order Instituting Proceedings in the First Proceeding (the "First OIP") was issued on July 31, 2008. The First OIP alleged, among other things, that Pierce violated §§ 5(a) and 5(c) of the Securities Act in that he "personally sold at least $2.7 million in Lexington stock" through an offshore bank "in June 2004 alone" in sales that were not registered with the Commission. The First OIP further alleged that Pierce violated Exchange Act §§ 13(d) and 16(a) and Rules 13d-1, 13d-2, and 16a-3 thereunder, in that:

> During most of the period from November 2003 to May 2004, Pierce owned or controlled between 10 and 60 percent of Lexington's outstanding stock. But Pierce did not file the required Schedule 13D until July 25, 2006.
>
> In the belatedly-filed Schedule 13D, Pierce inaccurately stated that he owned or controlled between 5 and 10 percent of Lexington's outstanding stock during late 2003, early 2004, and 2006. In reality, Pierce owned or controlled more than 10 percent of Lexington's stock during most of the period from November 2003 to May 2004.

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9 The investigative subpoena also required Pierce to produce "[a]ll statements from securities brokerage accounts… in which YOU have a beneficial interest or exercise discretionary control, or in whose profits and/or losses YOU share." Pierce objected "as to brokerage account statements of entities that have authorized discretionary trading of Lexington stock but have not authorized Mr. Pierce to produce their records."

10 Pierce does not dispute the Division's assertions regarding its efforts to obtain documents from Hypo Bank. These efforts are set forth in a declaration filed in support of the Division's Motion for Summary Disposition filed in the Second Proceeding and attachments to that declaration.

Although Pierce regularly traded Lexington stock in the open market for entities he controlled during 2004, Pierce never reported his ownership or changes in ownership on Forms 3, 4, or 5.[11]

The First OIP stated that issuance of cease-and-desist orders and the payment of disgorgement would be considered if the allegations were established and Pierce had no defenses to those allegations.

When the First OIP was issued, the Division had not received any materials in response to the requests directed to the FMA, nor had it received assurances from the FMA that such materials would be provided. But on December 10, 2008, the Division received a partial production of documents responsive to its February 20, 2008 request (the "First FMA Production"). The First FMA Production did not include documents for all of the Hypo Bank accounts that had traded in Lexington stock because certain unidentified account holders had filed appeals in Liechtenstein to prevent the FMA from providing such information to the Division. The FMA informed the Division that it would not produce additional documents until those appeals were resolved.

Thus, at the time of the First FMA Production, the Division did not know whether there were other accounts through which Pierce had traded Lexington shares. The Division accordingly clarified, before the administrative hearing began, that it sought disgorgement of only the proceeds of Pierce's unregistered sales through the Personal Account, a total of approximately $2 million. With only this amount at stake, the law judge held a hearing in February 2009, and closed the record of evidence on March 6, 2009.

Also on March 6, the Division learned that some of the appeals in Liechtenstein regarding the production of account documents had been resolved and that the FMA would make another partial production of documents for additional Hypo Bank accounts. The Division received these documents (the "Second FMA Production") on March 10, 2009. The Second FMA Production included documents related to the Personal and Corporate Accounts. Those documents showed trading activity in Lexington stock in all of these accounts and identified Pierce as the beneficial owner of the assets in the Corporate Accounts.

E. The law judge admitted new evidence for a limited purpose.

The Division moved to admit certain documents included in the Second FMA Production that related to the Personal and Corporate Accounts, and documents that showed trading activity in Lexington stock in those accounts (the "New Evidence"). The Division contended that the New Evidence was "material to [Pierce's] liability and the amount of disgorgement Pierce should be ordered to pay," and argued that "disgorgement far in excess of $2.1 million is warranted against Pierce in these proceedings."

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11 The First OIP also contained charges against Lexington and Atkins that are not at issue in this proceeding. *See supra* note 2 (discussing resolution of charges against Lexington and Atkins).

In ruling on the Division's motion, the law judge found that she lacked the authority to amend the First OIP by adding a §5 charge against Pierce based on his sales of Lexington stock in the Newport and Jenirob Accounts, and that ordering disgorgement based on sales from those accounts would be outside the scope of the First OIP. The law judge therefore admitted the New Evidence "for use on the issue of liability, but not for the purpose of disgorgement based on sales of stock by Newport and Jenirob."

F. The law judge issued an initial decision.

In the initial decision issued after the conclusion of the First Proceeding (the "First ID"),[12] the law judge found that Pierce violated Securities Act §§ 5(a) and 5(c) by offering and selling the 325,000 Option Shares of Lexington from the Personal Account.[13] She further found that Pierce violated Exchange Act §§ 13(d) and 16(a) and Rules 13d-1, 13d-2, and 16a-3[14] thereunder by failing to report certain levels of beneficial ownership of Lexington shares, basing her calculations on shares in the Corporate Accounts as well as the Personal Account.

In reaching her conclusion as to the § 5 violations, the law judge rejected Pierce's assertion that his Lexington sales were exempt under § 4(1) of the Securities Act,[15] which exempts from the registration requirements "transactions by any person other than an issuer, underwriter, or dealer." The intent of § 4(1), she found, is "to exempt routine trading transactions between members of the investing public and not distributions by issuers or the acts of others who engage in steps necessary to those distributions."[16] She found that the Division "adduced a significant amount of evidence" supporting its assertion that Pierce's control of Lexington made him an affiliate of Lexington, which brought him within the statutory definition of an issuer,[17] and that he therefore could not

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12 *Lexington Res., Inc.*, Initial Decision Release No. 379, 2009 SEC LEXIS 2099 (June 5, 2009).

13 The law judge did not base her findings of a § 5 violation on the sales of the 121,683 non-Option Shares from the Personal Account, though she did consider those shares in calculating Pierce's beneficial ownership of Lexington.

14 15 U.S.C. §§ 77m(d), 78p(a); 17 C.F.R. §§ 240.13d-1, 240.13d-2, 240.16a-3. Exchange Act Rule 16a-3, 17 C.F.R. § 240.16a-3, provides that statements of changes in beneficial ownership required by Exchange Act § 16(a) shall be filed on Form 4.

15 15 U.S.C. § 77(d)(1).

16 2009 SEC LEXIS 2099, at *44 (quoting *Owen V. Kane*, 48 S.E.C. 617, 619 (1986), *aff'd*, 842 F.2d 194 (8th Cir. 1988)).

17 *Id.* at *45. *See SEC v. Cavanaugh*, 155 F.3d 129, 134 (2d Cir. 1998) ("A control person . . . is an affiliate of an issuer and is treated as an issuer when there is a distribution of securities."); Securities Act § 2(a)(11), 15 U.S.C.§ 77(b)(a)(11) (defining "issuer" to include "any person directly or indirectly controlling or controlled by the issuer"); Securities Act Rule 144(a)(1), 17 C.F.R.§ 230.144(a)(1) (defining "affiliate of an issuer" as, among other things, "a person that directly, or indirectly through one or more of its intermediaries, controls . . . such issuer").

take advantage of the § 4(1) exemption with respect to sales from the Personal Account. The law judge also rejected Pierce's reliance on the Form S-8 filed by Lexington, calling that reliance "misplaced" and noting that "that registration statement did not contain a reoffer prospectus to cover Pierce's subsequent trades. . . . [H]is subsequent transactions must be registered, or he must present a valid exemption."[18]

The law judge ordered Pierce to cease and desist from violations of the provisions in question and to disgorge ill-gotten gains of $2,043,362.33 based on trading in Lexington stock in the Personal Account. She made no findings of liability regarding § 5 violations based on trading in the Corporate Accounts, and she did not order disgorgement of trading proceeds from transactions in those accounts.

Neither party sought review of the First ID, and the Commission did not call the matter for review. The First ID thus became the final decision of the Commission; a notice to that effect was entered on July 8, 2009, and the orders contained in the First ID were declared effective.[19]

G. The Commission initiated a second proceeding.

On June 8, 2010, the Commission issued an OIP against Pierce, Newport, and Jenirob (the "Second OIP").[20] In the Second OIP, the Division alleged that Pierce had violated Securities Act §§ 5(a) and 5(c) by selling unregistered shares of Lexington stock through Newport and Jenirob for profits of approximately $7.7 million. In his answer, Pierce admitted many of the facts and allegations set forth in the Second OIP, including facts related to (i) Lexington's corporate history and Pierce's control of Lexington, (ii) Lexington's issuance of millions of shares to Pierce and his associates, (iii) Pierce's promotional campaign touting Lexington stock, (iv) Pierce's beneficial ownership of the Corporate Accounts and his distribution of Lexington stock through Newport and Jenirob, and (v) the findings in the First ID that Pierce violated the Securities Act and the Exchange Act through unregistered sales of Lexington shares from the Personal Account. Pierce also admitted that as a result of conduct alleged in the Second OIP, he violated §§ 5(a) and 5(c) of the Securities Act. But Pierce stated that he admitted many of these facts and violations "solely because they were already adjudicated in the [First Proceeding], along with the request that [Pierce] 'should be ordered to pay disgorgement pursuant to Section 8A of the Securities Act.'" Pierce then contended that the Second Proceeding was barred by res judicata, equitable estoppel, judicial estoppel, and waiver. Both parties moved for summary disposition.

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18 2009 SEC LEXIS 2099, at *42-43.

19 *Gordon Brent Pierce*, Securities Act Release No. 9050, 2009 SEC LEXIS 2270, at *1 (July 8, 2009). *See* Rule of Practice 360(d)(2), 17 C.F.R. § 201.360(d)(2) (providing for issuance of finality orders).

20 *Lexington Res., Inc.*, Securities Act Release No. 9125, 2010 SEC LEXIS 1917 (June 8, 2010). On the same day, the Division applied in the United States District Court for the Northern District of California for a court order enforcing the monetary relief awarded in the First Proceeding, which Pierce had not yet paid. Pierce subsequently paid what was owed.

"[B]ased largely on the admissions contained in Pierce's Answer and on the Findings of Fact in the First [ID]," the law judge found that Pierce violated Securities Act §§ 5(a) and 5(c) as charged "by selling and offering to sell Lexington stock to the public through accounts held by Newport and Jenirob, when no registration statement had been filed or was in effect and with no exemption from registration."[21] He specifically found that Pierce admitted that he sold approximately 1.6 million Lexington shares through the Corporate Accounts at Hypo Bank between February 2004 and December 2004, and that no registration statements were filed relating to any resales of Lexington stock by Pierce, Newport, or Jenirob. The law judge then found that these admissions established the elements of a § 5 violation and that, together with the fact that Pierce was the beneficial owner of the assets in the Corporate Accounts, they establish that Pierce was liable as a necessary participant whose activities were also a substantial factor in the illegal sales. Pierce did not contend that he was entitled to an exemption. The law judge therefore found Pierce "presumptively liable" for violating § 5.[22]

The law judge rejected Pierce's assertions of equitable estoppel, judicial estoppel, and waiver as defenses to the proceeding. However, the law judge found that Pierce established that res judicata would have acted as a bar to the Second Proceeding, absent Pierce's efforts to hide his trading. Because those efforts kept the Division from knowing the full extent of Pierce's trading when the First Proceeding was instituted, the law judge held that an exception operated to avoid the res judicata bar.[23] Applying the fraudulent concealment exception, the law judge concluded that res judicata did not bar the Division from seeking disgorgement for the sales of unregistered shares from the Corporate Accounts that were not adjudicated in the First Proceeding.

Having found that the Division established that Pierce was liable for § 5 violations based on trading in the Corporate Accounts, and that res judicata did not preclude an order of disgorgement for the trading proceeds, the law judge imposed a cease-and-desist order against Pierce and ordered him to disgorge his profits from unregistered sales of Lexington shares in the Corporate Accounts, a total of $7,247,635.75.[24] This appeal followed.

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21 *Gordon Brent Pierce*, Initial Decision Release No. 425, 2011 SEC LEXIS 2564, at *5 & 20 (July 27, 2011).

22 *Id.* at *23.

23 *Id.* at *43 (citing, among other authority, RESTATEMENT (SECOND) OF JUDGMENTS § 26, comment j (1981); *Constantini v. Trans World Airlines*, 681 F.2d 1199, 1203 n.12 (9th Cir. 1982); *Mpoyo v. Litton Electro-Optical Sys.*, 430 F.3d 985, 988 (9th Cir. 2005)).

24 Pierce did not specifically dispute the Division's calculation of trading profits. The law judge also ordered Pierce to pay prejudgment interest.

Unlike in the First Proceeding, Newport and Jenirob were also respondents in this Second Proceeding. Judgment was entered by default against Jenirob and Newport. *Gordon Brent Pierce*, Securities Act Release No. 9205, 2011 SEC LEXIS 1669, at *1 (May 11, 2011). Cease-and-desist orders were entered against both, Newport was ordered to disgorge $5,264,466.64, and Jenirob was ordered to disgorge $1,983,169.11. *Id.* at *15-17. *See infra* note 100 and accompanying text

(continued...)

III.

A. Pierce violated § 5 through unregistered offers and sales of Lexington shares from the Corporate Accounts.

To establish a prima facie case for a § 5 violation against Pierce, the Division was required to show that (i) Pierce directly or indirectly sold or offered to sell the securities at issue; (ii) no registration statement was in effect or filed as to the transactions in which the securities were sold; and (iii) the sale or offer to sell was made through the use of interstate facilities or the mails.[25] The purpose behind the registration requirements is "to protect investors by promoting full disclosure of information thought necessary to informed investment decisions,"[26] and we have found this policy "equally applicable to the distribution of a new issue and to a redistribution of outstanding securities which 'takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering.'"[27]

The Second OIP alleged that Pierce deposited 1.6 million Lexington shares into the Corporate Accounts at Hypo Bank, that Pierce was the beneficial owner of the Corporate Accounts, and that Pierce sold the 1.6 million shares from the Corporate Accounts between February and December 2004 for net proceeds of more than $7 million. The Division introduced evidence in the form of bank and brokerage statements to support these assertions. It introduced Hypo Bank records showing that Pierce was the beneficial owner of the assets in the Newport and Jenirob Accounts at Hypo Bank. It introduced additional records showing that between February and September 2004, Newport realized gains of $5,264.466.64 from sales or deliveries of 1,308,400 Lexington shares and Jenirob realized gains of $1,983,169.11 from sales or deliveries of 435,000 Lexington shares, for a total of $7,247,635.75. Evidence introduced by the Division shows that these shares were sold from the Corporate Accounts through the Hypo Omnibus Account at vFinance.

The Second OIP further alleged that no registration statements were filed relating to any resales of Lexington stock by Pierce, Newport, or Jenirob.[28] Pierce points to no registration

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(...continued)
(finding that Pierce should be held jointly and severally liable with Newport and Jenirob respectively for disgorgement of these amounts).

25 *E.g.*, *World Trade Fin. Corp.*, Securities Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *23-24 (Jan. 6, 2012).

26 *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953).

27 *Ira Haupt & Co.*, 23 S.E.C. 589, 1946 SEC LEXIS 1359, at *13 (Aug. 20, 1946) (quoting *Report of Committee on Interstate & Foreign Commerce*, 73D CONG., 1ST SESS., H.R. Rep. No. 85, at 592 (1933)).

28 The Second OIP alleged that the registration statements on Form S-8 that purported to cover the issuance of the shares to Pierce and others under the stock option agreements "only purported

(continued...)

statements that allegedly cover those resales, and no such documents can be found on the Commission's EDGAR database. Pierce does not contend that he is entitled to an exemption from the registration requirements of § 5.[29] Thus, Pierce violated § 5 through his unregistered sales of Lexington from the Corporate Accounts, and unless he successfully asserts an affirmative defense, we would find him liable as charged.

B. Res judicata does not bar the Second Proceeding.

Pierce relies primarily on the affirmative defense of res judicata, under which a judgment on the merits in a prior suit bars a second suit based on the same cause of action that involves the same parties or their privies.[30] Res judicata "relieve[s] parties of the cost and vexation of multiple lawsuits, conserve[s] judicial resources, and, by preventing inconsistent decisions, encourage[s] reliance on adjudication."[31] In appropriate circumstances, res judicata applies to adjudicative decisions by administrative agencies.[32] But application of the doctrine may be different in an administrative context because of restrictions on the jurisdiction of the administrative forum or differences between the procedural systems in federal courts and administrative agencies.[33]

(...continued)

to cover issuances by Lexington, not any subsequent resales by Pierce . . . ." Pierce does not appear to be relying on the Forms S-8, but in any event, we find that those registration statements did not cover Pierce's resales of the Lexington shares through the Corporate Accounts.

[29] Exemptions from the registration requirements are affirmative defenses that must be established by the person claiming the exemption, and such exemptions "are construed strictly to promote full disclosure of information for the protection of the investing public." *SEC v. Cavanaugh*, 445 F.3d 105, 115 (2d Cir. 2006).

[30] *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 327 n.5 (1979).

[31] *Allen v. McCurry*, 449 U.S. 90, 94 (1980) (citing *Montana v. United States*, 440 U.S. 322, 327 n.5 (1979)).

[32] *See, e.g.*, *Jones v. SEC*, 115 F.3d 1173, 1178 (4th Cir. 1997) ("'When an administrative agency is acting in a judicial capacity and resolves disputed issues of fact properly before it which the parties have had an adequate opportunity to litigate, the courts have not hesitated to apply res judicata to enforce repose.'" (quoting *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394, 422 (1966) (superseded by statute on other grounds)).

[33] *See, e.g.*, RESTATEMENT (SECOND) OF JUDGMENTS §§ 24(a) (stating that "[e]quating claim with transaction is justified only when the parties have ample procedural means for fully developing the entire transaction in the one action going to the merits to which the plaintiff is ordinarily entitled"), 83 cmt. g (stating that "[t]he qualifications and exceptions to the rule of claim preclusion have particular importance with respect to administrative agencies" because, in contrast to Article III courts, the jurisdiction of agencies is more limited).

Moreover, "in the context of administrative proceedings, res judicata is not automatically and rigidly applied in the face of contrary public policy."[34]

To successfully assert a res judicata defense, a party must show "'(1) a final judgment on the merits in a prior suit, (2) an identity of the cause of action in both the earlier and the later suit, and (3) an identity of parties or their privies in the two suits.'"[35] Res judicata "'bars litigation of any claim for relief that was available in a prior suit between parties or their privies, whether or not the claim was actually litigated.'"[36] The party asserting res judicata has the burden of proof in establishing the defense.[37]

As concerns this appeal, we find (and the Division does not dispute) an identity of parties in the two cases for purposes of res judicata: Pierce, who asserts res judicata, and the Division, against whom res judicata is asserted, were parties to both the First Proceeding and the Second Proceeding.[38] We also find that the First Proceeding ended in a final judgment on the merits. Neither party sought review of the First Proceeding; the Commission did not call the matter for review; the First ID became the final decision of the Commission; and Pierce paid the monetary relief ordered.[39] But we find that the cause of action in the First Proceeding and the cause of action in the Second Proceeding are not identical.

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34 *Candelario v. Postmaster Gen. of U.S.*, 906 F.2d 798, 801 (1st Cir. 1990) (citations omitted).

35 *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 SEC LEXIS 367, at *56 (Feb. 13, 2009) (citing *Jones*, 115 F.3d at 1178), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010).

36 *Id.* at *55 (quoting *Transaero, Inc. v. La Fuerza Aerea Boliviana*, 162 F.3d 724, 731 (2d Cir. 1998)).

37 *E.g.*, *Winget v. JP Morgan Chase Bank, N.A.*, 537 F.3d 565, 572 (6th Cir. 2008); *Piper Aircraft Corp.*, 244 F.3d 1289, 1296 (11th Cir. 2001); *Karim-Panahi v. Los Angeles Police Dep't*, 839 F.2d 621, 627 n.4 (9th Cir. 1988); *United States v. Athlone Indus., Inc.*, 746 F.2d 977, 983 (3d Cir. 1984); *Bryson v. Guaranteed Reserve Life Ins. Co.*, 520 F.2d 563, 566 (8th Cir. 1975).

38 Although the First OIP and the Second OIP contained charges against other parties, the proceedings had been concluded as to those parties before the ID in each proceeding was entered. *See supra* notes 2 (discussing disposition of First Proceeding as to Atkins and Lexington), 24 (discussing disposition of Second Proceeding as to Jenirob and Newport). *See Bethesda Lutheran Homes & Servs. v. Born*, 238 F.3d 853, 857 (7th Cir. 2001) (Posner, J.) (citing *Dreyfus v. First Nat'l Bank*, 424 F.2d 1171, 1175 (7th Cir. 1990) ("[I]t is no objection that the former action included parties not joined in the present action, or vice versa, so long as the judgment was rendered on the merits, the cause of action was the same, and the party against whom the doctrine is asserted was a party to the former litigation."); *United States ex rel. Robinson Rancheria Citizens Council v. Borneo, Inc.*, 971 F.2d 244, 249 (9th Cir. 1992) (same)).

39 *See supra* note 19 and accompanying text (discussing issuance of finality order in First Proceeding), note 20 (discussing Pierce's payment of relief ordered in First Proceeding).

1. The proceedings do not involve the same cause of action.

The First Proceeding's causes of action included §5 claims against Pierce for his $2.7 million in unlawful sales through the Personal Account. The Second Proceeding's §5 claims related to the unlawful sales through the Corporate Accounts. These two distinct sets of claims gave rise to distinct violations of §5.

The question whether two proceedings involve the same cause of action is highly fact specific. "What constitutes a 'cause of action' for purposes of res judicata 'cannot be defined with precision,'"[40] nor can it be '"determined precisely by mechanistic application of a simple test.'"[41] Although the courts of appeals "have disavowed attempts to create a simple test for determining what constitutes a cause of action for res judicata purposes," they agree that the "focus of the inquiry is the 'essential similarity of the underlying events giving rise to the various legal claims.'"[42] "Factors relevant to this determination include: (1) whether the acts complained of were the same; (2) whether the material facts alleged in each suit were the same; and (3) whether the witnesses and the documentation required to prove such allegations were the same."[43] "The mere existence of common elements of fact between two claims does not establish the same cause of action if the critical acts and the necessary documentation were different for the two claims."[44] As one court has explained:

> With respect to the determination of whether a second suit is barred by res judicata, the fact that both suits involved essentially the same course of wrongful conduct is not decisive; nor is it dispositive that the two proceedings involved the same parties, similar or overlapping facts, and similar legal issues. A first judgment will generally have preclusive effect only where the transaction or connected series of transactions is the same, that is, "where the same evidence is needed to support both claims . . . . [45]

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[40] *Harris v. Jacobs*, 621 F.2d 341, 343 (9th Cir. 1980) (quoting 1B MOORE'S FEDERAL PRACTICE & PROCEDURE, ¶ 0.410(1) at 1154).

[41] *Id.* at 343 (quoting *Abramson v. Univ. of Haw.*, 594 F.2d 202, 206 (9th Cir. 1979)).

[42] *Marmon Coal Co. v. Dir., Office of Workers' Comp. Programs*, 726 F.3d 387, 394 (3d Cir. 2013) (quoting *Duhaney v. Att'y Gen.*, 621 F.3d 340, 347 (3d Cir. 2010)).

[43] *Id.* at 394-95.

[44] *Id.* at 395.

[45] *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1463-64 (2d Cir. 1996) (internal citations omitted; quoting *NLRB v. United Techs. Corp.*, 706 F2d 1254, 1260 (2d Cir. 1983)); *see also, e.g.*, *Harris*, 621 F.2d at 343 (stating that "'[t]he crucial element underlying all of the standards [for determining whether the same cause of action is involved in two suits] is the factual predicate of the several claims asserted. For it is the facts surrounding the transaction or occurrence which

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In both the First Proceeding and the Second Proceeding, Pierce was charged with violating § 5 of the Securities Act by selling shares of Lexington stock in transactions for which there was no registration statement in effect and for which there was no applicable exemption. But the § 5 cause of action in the First Proceeding did not embrace the unlawful transactions charged in the Second Proceeding. "Registration of a security is transaction-specific, in that the requirement of registration applies to each act of offering or sale; proper registration of a security at one stage does not necessarily suffice to register subsequent offers or sales of that security."[46] Because registration is transaction-specific, whether an offer or sale of securities violates § 5 requires an inquiry into whether those securities have been registered, or whether an exemption applies, with respect to that *particular* offer or sale.[47] Similarly, when an OIP charges violations of § 5, those charges must be framed in terms of particular transactions, not merely in terms of the securities themselves.

In paragraph 16 of the First OIP, the Division alleged that "Pierce personally sold at least $2.7 million in Lexington stock through the offshore bank [*i.e.*, Hypo Bank] in June 2004 alone. Pierce's sales were not registered with the Commission." As a result of this conduct, the OIP charged, Pierce violated § 5. The evidence needed to support this claim thus related only to the specific transactions charged: Pierce's unregistered sales of Lexington stock through the Personal Account.

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operate to constitute the cause of action . . . .'" (quoting *Expert Elec., Inc. v. Levine*, 554 F.2d 1227, 1234 (2d Cir. 1977)).

In addition to requiring that the same evidence be used to support the claims in both proceedings if the first proceeding is to have preclusive effect, *First Jersey* additionally requires that "the facts essential to the second [proceeding] were present in the first." 101 F.3d at 1464. We discuss below Pierce's argument that facts essential to the Second Proceeding were "present" in the First Proceeding.

46 *SEC v. Universal Express, Inc.*, 475 F. Supp. 2d 412, 422 (S.D.N.Y. 2007), *aff'd sub nom. SEC v. Altomare*, 300 F. App'x 70 (2d Cir. 2008); *see also* Eddy J. Rogers Jr. & Jason Weeden, *Resales of Securities Under the Securities Act*, 1012 PLI/Corp. 285, 297 (Sept. 1997) (because "[i]t is really the offering or sale of the particular security that is registered and not the security itself," each sale of a security must either be made pursuant to a registration statement or fall under a registration exemption).

47 *See, e.g., Cavanaugh*, 155 F.3d at 133 (rejecting contention that because issuance of shares had been registered on Form S-8 before shares were issued in 1996, registration was not required for subsequent sales of those shares in 1997 and recognizing "the long-standing reading of Section 5," under which "[a] registration statement permits an issuer, or other persons, to make only the offers and sales described in the registration statement" (citation omitted)); *Allison v. Ticor Title Ins. Co.*, 907 F.2d 645, 648 (7th Cir. 1990) ("Section 5 (the registration requirement) applies to transactions; each sale must be registered or exempt.").

Pierce contends that numerous facts about Newport and Jenirob were alleged in the First OIP, that the "predicate allegations" for the Division's request for disgorgement in the First Proceeding "included trading by 'his associates' and 'his offshore company,'" and that the Division "consistently maintained that Newport and Jenirob were among the 'associates' and 'offshore companies' through which Pierce had committed violations of the securities laws." Pierce further contends that the Division, in its post-hearing briefing, urged the law judge to award disgorgement based on trading proceeds in the Corporate Accounts. Therefore, he contends, liability for § 5 violations based on trading in the Corporate Accounts was at issue in the First Proceeding. Moreover, he contends, the First ID included findings "that on multiple occasions, Pierce sold Lexington shares through Hypo Bank's omnibus account at vFinance from different accounts that Pierce controlled."

We are not persuaded. As noted above, res judicata is not necessarily implicated when two proceedings involve "essentially the same course of wrongful conduct," or when they involve "the same parties, similar or overlapping facts, and similar legal issues."[48] The First OIP alleged additional facts regarding Lexington sales, *e.g.*, that "[b]etween February and July 2004, about 2.5 million Lexington shares were sold to the public through an omnibus brokerage account in the United States in the name of the offshore bank, generating sales proceeds of over $13 million." But the First OIP did not identify a seller or sellers of those 2.5 million Lexington shares, nor did it allege that no registration statement was in effect or filed with respect to those sales. Although the First OIP alleged that Lexington shares were transferred to Newport or Jenirob and referred to sales from the Hypo Omnibus Account, that was not enough to state a claim against Pierce based on unregistered sales from the Corporate Accounts, or to calculate the potential disgorgement from those sales. Thus, the only § 5 violations put at issue by the First OIP were Pierce's $2.7 million in unlawful sales through the Personal Account.

The law judge's admission of the New Evidence did not add new charges to the First Proceeding. In ruling on the Division's motion, the law judge recognized that the Commission has not delegated authority to law judges to expand the scope of matters set down for hearing beyond the framework of an original OIP.[49] For that reason, she admitted the New Evidence for the

48 *First Jersey*, 101 F.3d at 1463.

49 *See* Rule of Practice 200(d)(2), 17 C.F.R. § 201.200(d)(2) (providing that a hearing officer, upon motion by a party, "may . . . amend an order instituting proceedings to include new matters of fact or law that are within the scope of the original order instituting proceedings"); *J. Stephen Stout*, 52 S.E.C. 1162, 1996 SEC LEXIS 3557, at *2 n.2 (Dec. 10, 1996) (holding that a hearing officer correctly denied a motion to include a request for civil money penalties that was unintentionally omitted from the order instituting proceedings and citing comment (d) to Rule 200 of the Rules of Practice, because, "since the Commission has not delegated its authority to authorize orders instituting proceedings, hearing officers do not have authority to initiate new charges or to expand the scope of matters set down for hearing beyond the framework of the original order instituting proceedings"). The law judge additionally noted that Pierce had opposed

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limited purpose of liability as to the charges contained in the First OIP—§ 5 violations based on Pierce's sales from the Personal Account, plus the Exchange Act violations charged—and not for purposes of deciding liability for sales not included in the First OIP, *i.e.*, sales from the Corporate Accounts.

We also reject Pierce's argument that the Division's request for disgorgement of trading proceeds from the Corporate Accounts in its post-hearing brief placed § 5 liability for sales from those accounts at issue in the First Proceeding. The Division sought that result, but the law judge refused to allow it because the § 5 liability for those sales was beyond the scope of that proceeding. The Division filed its post-hearing brief after it had moved to admit the New Evidence, but before the law judge admitted the New Evidence for limited purposes. So when the Division filed its post-hearing brief, it was not clear how the law judge would rule on its motion to admit the New Evidence. Subsequently, as discussed above, she ruled that no request for additional disgorgement would be entertained because disgorgement based on sales from the Corporate Accounts would be outside the scope of the First OIP. Thus, despite the Division's attempts to obtain disgorgement for the trading proceeds from the Corporate Accounts in the First Proceeding, the law judge ruled against the Division on the grounds that such a request was not part of that proceeding and that she did not have authorization to add it.[50]

Nor do the law judge's findings related to sales from the Corporate Accounts in the First ID establish that liability under § 5 for those sales was at issue in the First Proceeding. The law judge made clear, both in her order disposing of the motion to admit the New Evidence and in the First ID, that she was operating within the constraints on her authority established by the parameters of the First OIP, which did not include §5 claims against Pierce based on the trades in the Corporate Accounts. The law judge's factual findings regarding transactions in Lexington shares related only to issues properly within those parameters. Some of her findings with respect to the Lexington shares show that Pierce was involved in a distribution of Lexington shares; they thus support her rejection of Pierce's affirmative defense that he was entitled to take advantage of the § 4(1) exemption with respect to sales from the Personal Account. Additionally, her findings related to sales of Lexington shares support her legal conclusions that Pierce's beneficial ownership of Lexington shares attained levels that required reporting under the Exchange Act provisions charged. But her findings concerning specific § 5 violations are limited to the transactions in the Personal Account. Consistent with those findings, and with her order disposing of the motion to admit the New Evidence, the disgorgement ordered was limited to the illegal, unregistered transactions out of the Personal Account.

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the admission of the New Evidence, arguing that admitting the evidence after the hearing had been closed would violate due process.

50 *See, e.g.*, *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1191 (9th Cir. 1980) (finding that disgorgement of ill-gotten gains "is designed [in part] to deprive a wrongdoer of unjust enrichment" resulting from a violation of the securities laws).

Pierce mischaracterizes the nature of the claim at issue in the Second Proceeding as "disgorgement claims against Pierce for Lexington stock trading profits comprising the $13 million" that the Division alleged in the First OIP were earned by "Pierce and his associates." The claim that is the basis of the Second Proceeding is that Pierce violated § 5 through his sales of Lexington stock in the Newport and Jenirob Accounts. Disgorgement is a remedy for successfully establishing this claim, not the claim itself.

Accordingly, we find that the First Proceeding and the Second Proceeding did not involve the same cause of action and that therefore res judicata does not bar this proceeding.[51]

2. Pierce's fraudulent concealment would defeat any application of res judicata.

Courts have consistently held that res judicata does not apply where facts are fraudulently concealed and could not have been discovered with due diligence.[52] Here, even if the cause of action in the First Proceeding, based on the transactions in the Personal Account, and the cause of action in the Second Proceeding, based on the transactions in the Corporate Accounts, could be considered the same, we find that res judicata still would not apply because Pierce fraudulently concealed the transactions in the Corporate Accounts and the Division exercised due diligence in attempting to uncover them. To find otherwise would reward Pierce for his duplicitous conduct.

Pierce successfully concealed his involvement in the unregistered Lexington sales from the Corporate Accounts until after the Division had filed the First OIP: he failed to disclose the trades made on his behalf through the Newport Account that are at issue here, failed to disclose any of the trades made on his behalf in the Jenirob Account, and denied having an interest in the Jenirob

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[51] *See Greenberg v. Bd. of Governors of the Fed. Reserve Sys.*, 968 F.2d 164, 168-70 (2d Cir. 1992) (finding that because "preclusion is limited to the transaction at issue in the first action" and thus "[l]itigation over other transactions, though involving the same parties and similar facts and legal issues, is not precluded," prior enforcement actions concerning "functionally similar" transactions did not bar subsequent enforcement action); *Proctor v. LeClaire*, 715 F.3d 402, 412-13 (2d Cir. 2013) (finding that prisoner's first action challenging his initial confinement to a Special Housing Unit did not bar his subsequent action challenging his continued confinement in the Special Housing Unit, despite facts that some of the periodic reviews leading to his continued confinement had occurred at the time he commenced his first action challenging the initial confinement and that the court in the first action discussed the periodic reviews in rejecting his challenge to his initial confinement, because "the initial authorization for confinement and the subsequent decisions to continue confinement—although plainly involving considerations that overlap—are not, and could not reasonably be expected to be, the 'same transaction'").

[52] *See, e.g.*, *Mpoyo*, 430 F.3d at 988; *Haefner v. N. Cornwall Twp.*, 40 F. App'x 656, 658 (3d Cir. 2002); *L-Tec Elecs. Corp. v. Cougar Elec. Org., Inc.*, 198 F.3d 85, 88 (2d Cir. 1999); *Doe v. Allied-Signal, Inc.*, 985 F.2d 908, 914 (7th Cir. 1993); *Harnett v. Billman*, 800 F.2d 1308, 1313 (4th Cir. 1986); *Guerrero v. Katzen*, 774 F.2d 506, 508 (D.C. Cir. 1985); *see also* RESTATEMENT (SECOND) OF JUDGMENTS § 26, comment j.

Account. Lacking knowledge of the full extent of Pierce's unregistered sales, the Division was unable to allege elements of the § 5 violation based on sales in the Corporate Accounts when the Commission instituted the First Proceeding.

Pierce contends that the fraudulent concealment exception is not available to the Division because the Division had enough evidence to include a request that Pierce disgorge "Lexington stock trading profits comprising the $13 million allegedly obtained by 'Pierce and his associates'" in the First Proceeding. He notes that the Division alleged in the First OIP that Pierce and his associates earned $13 million and contends that the Division thus "represented to the public in effect that it had sufficient information to allege elements of joint and several liability for $13 million against Pierce at the outset." Pierce further contends that the Division had additional evidence of Pierce's beneficial ownership of Lexington stock through Newport from the Schedule 13D he filed in July 2006. Additionally, Pierce contends that "a fair reading" of the record establishes that he did not lie about his ownership of Newport and Jenirob, and that he did not "conceal" the existence of the Hypo Bank records, about which the Division clearly knew in 2006 when it asked the FMA for those records.

The record does not support Pierce's interpretation of the evidence he provided to the Division in connection with the First Proceeding.[53] When Pierce produced the Schedule 13D in July 2006, he did so in response to an investigative subpoena that required him to produce "[a]ll statements from securities brokerage accounts . . . in which YOU have a beneficial interest or exercise discretionary control, or in whose profits and/or losses YOU share," and "[a]ll DOCUMENTS reflecting or relating to . . . transactions by YOU" in Lexington stock, with "YOU" defined to include "any person or entity acting on [Pierce's] behalf." By producing the Schedule 13D in response to the subpoena, Pierce implicitly represented that it constituted all "responsive records . . . of trades in Lexington stock" by him or on anyone acting on his behalf. But the Schedule 13D did not list all the trades Pierce made through the Newport Account—in fact, it did not list any of the Newport trades at issue in this proceeding—and it did not reveal Pierce's beneficial ownership of assets in the Jenirob Account at all. Moreover, in his investigative testimony Pierce falsely denied having an interest in the Jenirob Account and denied trading in Lexington securities in any U.S. account on behalf of Jenirob. Furthermore, although Pierce did not conceal the existence of the Hypo Bank records from the Division, Liechtenstein laws governing secrecy of bank accounts are well known; indeed, Pierce took advantage of them to delay the FMA's production of documents to the Division by filing an appeal. He was thus aware that it was unlikely that the Division would obtain trading records that would allow it to determine which accounts (within the framework of the Hypo Omnibus Account) were trading in Lexington shares and who owned, or beneficially owned, those accounts. By providing the Schedule 13D as

[53] We reject Pierce's characterization of the effect of the allegation in the First OIP that Pierce and his associates earned $13 million. It does not follow that because the Division had evidence to support the allegation concerning the $13 million, it had evidence to support the elements of a prima facie case as to transactions other than those in the Personal Account. For the reasons discussed above, the Division did not have such evidence.

an incomplete and misleading response to the Division's investigative subpoena, omitting from the Schedule 13D all of the relevant trades from the Newport Account, denying any interest in the Jenirob Account, denying having traded in the Jenirob Account, and taking advantage of the Liechtenstein bank secrecy laws, Pierce contrived to make it difficult, if not impossible, for the Division to learn of his concealment in time to include allegations regarding trades in the Corporate Accounts in the First Proceeding. We find that Pierce's provision of false and misleading information to the Division was purposeful, and that this dishonest conduct, together with his taking advantage of Liechtenstein's secrecy laws, constituted a fraudulent effort to conceal Pierce's trading in the Corporate Accounts from the Division.

Because of lies and omissions in the Schedule 13D and in Pierce's investigative testimony, the Division could not support the allegations necessary to establish its prima facie case that the sales at issue were made through the Corporate Accounts, that Pierce made the unregistered sales in the Corporate Accounts, or that Pierce was the beneficial owner of the assets in those accounts, nor could it have adduced the evidence necessary to support the remedy of disgorgement of the trading proceeds, until it obtained the documents in the Second FMA Production, which provided the Division, for the first time, with evidence of the specific transactions that were later put at issue in the Second Proceeding. Thus, the Division could not have included in the First OIP the claim of a § 5 violation based on trading in the Corporate Accounts, and therefore could not have sought disgorgement of any such trading profits.

Pierce contends that the Division failed to make diligent efforts to obtain records relevant to trading in the Corporate Accounts. He contends that the Division could have subpoenaed Hypo Bank, Newport, or Jenirob, and/or it could have filed a motion to compel Pierce to produce documents. Had the Division taken these steps, Pierce contends, either it would have obtained the documents, enabling it to assert the additional § 5 claims in the First Proceeding, or it would have obtained a ruling "that Pierce's objections were proper," in which case, he argues, the Division would have no claim of "fraudulent" concealment.

We find that the Division acted with appropriate diligence in pursuing information about Pierce's trading through accounts other than the Personal Account. Pierce responded untruthfully to questions asked during investigative testimony and misleadingly to the Division's subpoena. The Division was not required to assume that Pierce's responses were false or misleading and to subpoena other potential sources of information; rather, it was entitled to take Pierce at his word. And besides, given that Pierce lied under oath during his investigative testimony and filed misleadingly incomplete responses to the subpoena, we see no reason to believe that Pierce's responses to any additional subpoenas would have been more forthcoming. Moreover, Pierce's deceptive conduct failed to put the Division on notice that any documents that might have been produced by Lexington, Newport, or Jenirob would have contained relevant information about additional Lexington trades. Finally, the Division requested records from the FMA, and when it learned in late 2007 that changes in the law might make it possible to get documents that had previously been unavailable, it promptly submitted a renewed request. Given the bank secrecy laws in effect in Liechtenstein, any notion that a subpoena to Hypo Bank would have been more productive is speculative. We find no lack of diligence that would preclude the application of the fraudulent concealment exception.

Pierce contends that the Division "may have prematurely initiated the First Case, before it had acquired every last document tracing Lexington share proceeds in the distribution. But the res judicata doctrine requires that it now be bound by the consequences." Those "consequences," Pierce argues, include the loss of the right to seek disgorgement of the trading proceeds in the Corporate Accounts in a second proceeding.

We disagree. The First Proceeding was brought in part to obtain cease-and-desist orders pursuant to Securities Act § 8A and Exchange Act § 21C against Pierce to stop any further violations of § 5, as well as of Exchange Act §§ 13(d) and 16(a). The legislative history of §§ 8A and 21C shows that Congress intended the cease-and-desist authority to be an expeditious means of addressing ongoing violations of the federal securities laws. A Senate Report noted that, in view of the "extremely congested nature of federal court dockets, which often results in considerable delays in cases being heard, the authority to issue an administrative cease-and-desist order will enable the SEC to respond in a more timely fashion to [violative] conduct or practices."[54] Thus, Congress intended the Commission to use its new authority to quickly prevent further wrongdoing and injury to the markets and the investing public. Requiring the Division to identify every possible violation of § 5 perpetrated by a particular respondent before instituting such a proceeding—especially when those engaging in violative conduct are doing their best to thwart the Division's efforts—would run counter to this objective and disserve the investing public.[55] Further, adopting such a requirement could encourage wrongdoers to take additional steps to cover their tracks: for example, they might arrange to trade through accounts in multiple foreign jurisdictions, hoping that res judicata would protect the proceeds of such trades if they remained undiscovered long enough.

Moreover, the Division could not have accurately predicted how long it would take to get adequate information about sales from the Corporate Accounts. As set forth above, the FMA initially refused to provide any documents in response to the Division's request and could not provide such documents absent legislative change in Liechtenstein, a process over which the Division had no control and the duration of which the Division could not predict. Even after the legislative changes were made, the FMA notified the Division that it would not comply completely with the Division's requests at least until the pending appeals were concluded.[56] Because of Pierce's dishonest conduct, the Division could not have known whether any Hypo Bank materials it might ultimately obtain would have provided evidence of additional § 5 violations against Pierce. The Division may have suspected that there was evidence of value in the Hypo Bank records. But even if it thought the records might show transactions in the Corporate Accounts, the Division had no reason to suspect that those trades could give rise to charges against Pierce in light of his denials regarding his relationship to those entities. For these reasons, delaying the issuance

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[54] S. Rep. No. 101-337, at 18 (1990), 1990 WL 263550.

[55] *See supra* note 34 and accompanying text.

[56] If the appeals had succeeded, the release of the documents to the Division would presumably have been even further delayed, perhaps indefinitely.

of the First OIP while awaiting the receipt of hypothetical information would not have been in the public interest. Although avoiding piecemeal litigation is one of the purposes of res judicata, that objective does not override the objective of initiating cease-and-desist proceedings expeditiously. The Division therefore acted appropriately in proceeding with the § 5 claims based on sales from the Personal Account and the Exchange Act claims.

3. The Division was not required to ask the Commission to amend the OIP.

Pierce contends that the fraudulent concealment exception to res judicata applies only when the concealed evidence and the resulting claims are not discovered until after a final judgment has been issued, suggesting that the Division was limited to bringing the new claim concerning the sales from the Corporate Accounts as an amendment to the First Proceeding. Pierce also contends that, in this case, the New Evidence was not only discovered during the First Proceeding, it was also submitted to the law judge, asserted as the basis for a request for disgorgement, and even relied on by the law judge in the First ID as evidence for the claims asserted in that proceeding. Therefore, Pierce argues, the Division was limited to using the evidence in the First Proceeding, or in an appeal from the First Proceeding, and was barred from using that evidence as a basis for a second action.

Pierce cites no cases in support of such a limitation on the availability of the fraudulent concealment exception to res judicata. To the contrary, the *Second Restatement of Judgments*, on which he relies, suggests that the fraudulent concealment exception applies to any concealment that, as in this case, continues beyond the time the first action is brought:

> [W]hen the plaintiff brings an action against the defendant for cancellation of a contract made between them, alleging that the plaintiff was mentally incompetent at the time of the making of the contract, and a verdict and judgment are given for the defendant, the plaintiff is not precluded from maintaining a second action for the cancellation of the contract on the ground of a misrepresentation the defendant concealed from the plaintiff at the time when the first action was brought.[57]

Another line of res judicata cases similarly indicates that discovery of a fraudulent concealment after initiation of a lawsuit but before a final judgment is rendered does not preclude the use of the exception. In cases where additional misconduct occurs after a suit is filed but is discovered before a final judgment is issued, the courts have held that there is no obligation to amend the complaint to add claims based on the additional misconduct.[58] The courts have

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[57] RESTATEMENT (SECOND) OF JUDGMENTS § 26, comment j.

[58] *See, e.g., Morgan v. Covington Twp.*, 648 F.3d 172, 177-78 (3d Cir. 2011) ("Five other Courts of Appeals have already adopted a bright-line rule that res judicata does not apply to events post-dating the filing of the initial complaint. . . . We see no reason to part with our sister Circuit Courts." (citations omitted)); *First Jersey*, 101 F.3d at 1465; *Los Angeles Branch NAACP v. Los Angeles Unified Sch. Dist.*, 750 F.2d 731, 739 & n.9 (9th Cir. 1984).

declined "to impose a potentially unworkable requirement that every claim arising prior to entry of a final decree must be brought into the pending litigation or lost."[59] "A contrary rule would only invite disputes about whether plaintiffs could have amended their initial complaints to assert claims based on later-occurring events."[60]

> The notion that the agency must either perpetually expand its charges to pursue new unlawful acts in an ongoing proceeding or lose the ability to pursue the persistent violator for misdeeds between the start and conclusion of the proceeding would in effect confer on the miscreant a partial immunity from liability for future violations. Such a notion is both antithetical to the regulatory scheme and inconsistent with the doctrine of res judicata.[61]

We believe that the reasoning in these cases is equally applicable in cases where, as here, additional misconduct occurs before a suit is filed but is not discovered until after the suit is commenced, "at least where the plaintiff contends the [additional misconduct] was unknown due to [the] defendant's fraud."[62] This is because the impact on the plaintiff in both circumstances is the same, *i.e.*, the plaintiff, through no fault of its own and due to circumstances solely within the control of the defendant, is unaware of the evidence necessary to establish the defendant's additional misconduct until after the initiation of the first lawsuit. Such a rule neither penalizes the plaintiff nor rewards the defendant for the defendant's wrongdoing. Rather, it "puts the focus properly on whether plaintiff was diligent in pursuing its claims, not on whether the discovery was made in time to permit an amendment to the complaint."[63]

Pierce's argument also fails to recognize that special considerations apply in an administrative forum such as this one. In a federal court of general jurisdiction, the judge in whose court the action is pending has considerable latitude to permit pleadings to be amended, even to the extent of adding new claims.[64] In our administrative proceedings, in contrast, a law judge lacks the authority to amend an OIP to include matters outside its original scope; expanding the scope of the OIP requires action by the Commission.[65] Thus, the law judge in the First Proceeding lacked the authority to amend the First OIP to include charges based on transactions in the Corporate

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59 *Los Angeles Branch NAACP*, 750 F.2d at 739 n.9.

60 *Morgan*, 648 F.3d at 178.

61 *First Jersey*, 101 F.3d at 1465.

62 *Allied Fire Prot. v. Diede Constr., Inc.*, 25 Cal. Rptr. 3d 195, 2005 Cal. App. LEXIS 296, at *14 (Cal. Dist. Ct. App. 2005).

63 *Id.*

64 *See generally* FED. R. CIV. PROC. 15.

65 *See* Rules of Practice 200(d)(1) and (2); *see also supra* note 49 (discussing Rule of Practice 200(d)(2)).

Accounts and correctly declined to do so, and those charges were not put at issue when the Division received the Second FMA Production and introduced the New Evidence in March 2009.

Nor, in the circumstances presented here, was the Division required to make additional attempts to incorporate the claims of § 5 violations based on trading in the Corporate Accounts into the First Proceeding. Although the Division could have petitioned for interlocutory review of the law judge's order disposing of the motion to admit the New Evidence,[66] the outcome of such a petition would have been uncertain: such petitions are disfavored, and proceedings are not automatically stayed pending the Commission's determination.[67] Failure to stay the proceeding at such an advanced, post-hearing stage could have meant that the Commission reached no determination on any interlocutory motion before the law judge issued an initial decision. On the other hand, staying the proceeding at such a late stage would have further delayed the resolution of claims that had already been litigated to their conclusion in the First Proceeding, and consequently delayed the imposition of any remedial sanctions.[68] Moreover, had the Commission determined to permit the amendment of the OIP, whether in response to an interlocutory appeal or to any appeal that might have been filed after issuance of the First ID, this would also have led to re-opening the hearing and allowing new post-hearing briefs, further delaying the resolution of the First Proceeding and the implementation of any remedial sanctions.[69] Thus, the negative consequences of requiring the Division to take such steps would have outweighed any potential marginal savings in costs to the parties and conservation of judicial resources.[70]

Res judicata based on the Division's inability to seek disgorgement of the profits from the transactions in the Corporate Accounts without amending the OIP would be particularly inappropriate in this administrative proceeding. As noted above, res judicata applies "more

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66 *See* Rule of Practice 400, 17 C.F.R. § 201.400.

67 *See id.,* Rules 400 (a) and (d).

68 Alternatively, the Division could have filed a motion with the Commission to amend the OIP; such a motion would have been fraught with similar difficulties concerning the possibility of a stay of the underlying proceeding.

69 If a party timely files a petition for review of an initial decision, the initial decision does not become final as to that party. Rule of Practice § 201.360(d)(1), 17 C.F.R. § 201.360(d)(1). Thus, any sanctions imposed in the First Proceeding would have been put on hold while the Commission considered the appeal.

70 *See Thompson v. Schweiker*, 665 F.2d 936, 940, 1982 U.S. App. LEXIS 22742, at *12 (9th Cir. 1982) (finding that enforcement of administrative res judicata should be tempered by fairness and equity and that administrative res judicata "does not acquire the rigid finality of judicial proceedings"); *Cartier v. Secretary*, 506 F.2d 191, 196, 1974 U.S. App. LEXIS 6300, at *14 (D.C. Cir. 1974) (finding that administrative res judicata should not be blindly applied in every context, and should be rejected when the reasons against applying it outweigh those that favor it).

flexibly in the administrative context"[71] and is "qualified or rejected" when its application "would contravene an overriding public policy."[72] As one court explained,

> "[t]he entire purpose and thrust of a [Commission] enforcement action is to expeditiously safeguard the public interest by enjoining securities violations. The claims asserted in such an action stem from, and are colored by, the intense public interest in [Commission] enforcement of these laws. ". . . Disgorgement plays a central role in the enforcement of the securities laws. "The effective enforcement of the federal securities laws requires that the [Commission] be able to make violations unprofitable. The deterrent effect of [a Commission] enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits." By deterring violations of the securities laws, disgorgement actions further the Commission's public policy mission of protecting investors and safeguarding the integrity of the markets.[73]

At least in the context of an administrative proceeding seeking disgorgement for fraudulently concealed securities law violations, res judicata should not apply to frustrate the public policy goal of making securities law violations unprofitable.[74]

C. The Commission is not equitably estopped from bringing the Second Proceeding.

Pierce contends that the Commission is equitably estopped from bringing the current proceeding because the Division failed to appeal the law judge's initial decision in the First Proceeding. This defense fails for several reasons. As the Supreme Court has stated, "equitable estoppel will not lie against the Government as it lies against private litigants."[75] To the extent

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[71] *Maldonado v. U.S. Att'y Gen.*, 664 F.3d 1369, 1377 (11th Cir. 2011).

[72] *Martin v. Donovan*, 731 F.2d 1415, 1416 (9th Cir. 1984) (citation omitted).

[73] *SEC v. Rind*, 991 F.2d 1486, 1491 (9th Cir. 1993) (quoting *SEC v. Asset Mgmt Corp.*, 465 F. Supp. 998, 1000 (S.D. Ind. 1978) and *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1104 (2d Cir. 1972)).

[74] *Cf. Duhaney v. Att'y Gen. of the U.S.*, 621 F.3d 340, 351 (3d. Cir. 2010) (finding that Congress's intent "to facilitate the removal of aliens who have committed aggravated felonies counsels against an overly rigid application of the res judicata doctrine" because the doctrine "should not be applied so as to frustrate clearly expressed congressional intent.").

[75] *Office of Personnel Mgmt. v. Richmond*, 496 U.S. 414, 420 (1990).

equitable estoppel is available at all,[76] "[a] party attempting to apply equitable estoppel against the government must show that '(1) there was a definite representation to the party claiming estoppel, (2) the party relied on its adversary's conduct in such a manner as to change his position for the worse, (3) the party's reliance was reasonable[,] and (4) the government engaged in affirmative misconduct.'"[77]

The Division's decision not to appeal from the First ID was not a "definite representation" that it was abandoning a claim for disgorgement related to Pierce's trading in the Corporate Accounts. The decision represented at most an acceptance of the law judge's conclusion that the question of § 5 liability for the Lexington stock transactions through the Corporate Accounts went beyond the scope of the First OIP. By not appealing, the Division did not represent that further disgorgement from Pierce was unavailable; the Division had other options, including the one it pursued, *i.e.*, asking the Commission to institute a new proceeding alleging separate violations related to trading in the Corporate Accounts. And the Division's conduct gave Pierce no reason to believe that the Division would *not* initiate such a proceeding, thereby lulling him into forgoing an appeal of his own.

In any event, Pierce cannot rightfully claim that he relied on the Division's decision not to appeal in making his own determination not to appeal. The period for filing an appeal ran concurrently for the parties.[78] Pierce could not have known for certain that the Division would not appeal the First ID until after the period for filing his own appeal had already lapsed. He could not,

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[76] *Id.* at 422–23 (noting that the Supreme Court has "reversed every finding of estoppel that [it has] reviewed" and that the arguments for a rule that estoppel would never lie against the government were "substantial," but nevertheless deciding to leave "for another day whether an estoppel claim could ever succeed against the Government"); *Savoury v. U.S. Att'y Gen.*, 449 F.3d 1307, 1318 (11th Cir. 2006) ("[I]t is far from clear that the doctrine of equitable estoppel may even be applied against a government agency.").

[77] *Keating v. FERC*, 569 F.3d 427, 434 (D.C. Cir. 2009) (quoting *Morris Commc'ns, Inc. v. FCC*, 566 F.3d 184, 191-92 (D.C. Cir. 2009)); *see also Dickow v. United States*, 654 F.3d 144, 152 (1st Cir. 2011); *Mich. Express, Inc. v. United States*, 374 F.3d 424, 427 (6th Cir. 2004). The parties, the law judge, and some courts of appeals have used a test that is consistent with *Keating*, although they have articulated the basic requirements for equitable estoppel somewhat differently, requiring that (i) the party to be estopped knows the facts; (ii) he intends that his conduct will be acted on or must so act that the party invoking estoppel has a right to believe it is so intended; (iii) the party invoking estoppel is ignorant of the true facts; and (iv) he detrimentally relies on the former's conduct. *See Pierce*, 2011 SEC LEXIS 2564, at *24 (citing *United States v. Gamboa-Cardenas*, 508 F.3d 491, 502 (9th Cir. 2007)); *see also FDIC v. Hulsey*, 22 F.3d 1472, 1489–90 (10th Cir. 1994). Under either version of the test, Pierce has failed to show that equitable estoppel is appropriate here.

[78] *See* Rule of Practice 410(b), 17 C.F.R. § 201.410(b) (setting forth procedures for filing petitions and cross-petitions for review of initial decisions by hearing officers).

therefore, have relied on the Division's decision not to appeal in making his own determination not to appeal.

Moreover, even if it could be argued that Pierce somehow relied upon the Division's decision not to appeal, that reliance was not reasonable. Pierce contends that it was reasonable to assume that the Division would have filed a petition to review the $2.1 million disgorgement order in order to "preserve the $7.5 million claim through the application of the Commission's own rules for the amendment, review, and modification of the disgorgement order for $2.1 million." But this argument again rests upon the faulty premise that seeking Commission review of the First ID was the sole option for pursuing disgorgement related to trading in the Corporate Accounts. As already discussed, asking the Commission to amend, review, or modify the disgorgement ordered in the First ID was not the only (or even the most appropriate) avenue available to the Division to pursue additional disgorgement, and it was reasonable for the Division to interpret the First ID as suggesting that a separate action related to the Corporate Accounts transactions was appropriate. Pierce, on the other hand, asserts that it was reasonable for him to rely "on the longstanding doctrine of res judicata" to bar the Division from bringing a separate action, making it also reasonable for him to interpret the Division's failure to appeal as an indication that it did not intend to seek additional disgorgement. But even if Pierce planned to assert res judicata as a defense in any subsequent proceeding, it is speculation on Pierce's part that the prospect of his raising such a defense would cause the Division to conclude that its only hope of obtaining the additional $7.5 million in profits would be to appeal the First ID. It was thus unreasonable for Pierce to simply assume that, if the Division did not appeal, it would not pursue additional disgorgement through a separate action.

Further, there is no evidence of any "affirmative misconduct" by the Division. Affirmative misconduct involves "more than mere negligence, delay, [or] inaction" by a government agency;[79] it requires "an affirmative misrepresentation or affirmative concealment of a material fact."[80] There is no basis to conclude that the Division's decision not to appeal constituted an affirmative misrepresentation or an affirmative concealment of a material fact. For this reason alone, Pierce's equitable estoppel argument must fail.

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[79] *Robertson-Dewar v. Holder*, 646 F.3d 226, 229 (5th Cir. 2011); *see also Premo v. United States*, 599 F.3d 540, 547 (6th Cir. 2010) ("Affirmative conduct 'is more than mere negligence. It is an act by the government that either intentionally or recklessly misleads the claimant.'" (quoting *Mich. Express*, 374 F.3d at 427)).

[80] *Dickow*, 654 F.3d at 152; *Robertson-Dewar*, 646 F.3d at 230; *Watkins v. U.S. Army*, 875 F.2d 699, 707 (9th Cir. 1989) (en banc); *see also GAO v. Gen. Accounting Office Pers. Appeals Bd.*, 698 F.2d 516, 526 (D.C. Cir. 1983) ("Estoppel generally requires that government agents engage—by commission or omission—in conduct that can be characterized as misrepresentation or concealment, or, at least, behave in ways that have [caused] or will cause an egregiously unfair result.").

Finally, "estoppel will only apply where the government's wrongful act will cause a serious injustice, and the public's interest will not suffer undue damage."[81] This requirement is grounded in the recognition that "[w]hen the government is unable to enforce the law because the conduct of its agents has given rise to an estoppel, the interest of the citizenry as a whole in obedience to the rule of law is undermined."[82] The Division's pursuit of a separate action based on unregistered sales in the Corporate Accounts is by no means unjust, especially since, as the law judge in the current proceeding noted, Pierce has had the opportunity to vigorously defend himself in this separate action, including by challenging the Commission's ability to bring it. On the other hand, the public interest would be seriously undermined if Pierce's misplaced reliance on the Division's decision not to appeal the decision in the First Proceeding prevented the Commission from pursuing the disgorgement of millions of dollars of ill-gotten gains. For all of the above reasons, we reject Pierce's equitable estoppel defense.

D. The Commission is not judicially estopped from bringing the Second Proceeding.

Pierce's judicial estoppel defense fares no better. The doctrine of judicial estoppel "applies when, among other things, a 'party has succeeded in persuading a court to accept that party's earlier position, so that judicial acceptance of an inconsistent position in a later proceeding would create the perception that either the first or the second court was misled.'"[83] Accordingly, the Supreme Court has identified three factors relevant to whether the doctrine of judicial estoppel will apply in a particular case: (i) whether "a party's later position [is] 'clearly inconsistent' with its earlier position"; (ii) "whether the party has succeeded in persuading a court to accept that party's earlier position"; and (iii) "whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped."[84] Pierce argues that the Division should be estopped in this proceeding from seeking disgorgement related to his trading in the Corporate Accounts because the Division had argued in the First Proceeding for the additional $7.5 million in disgorgement. We conclude that the doctrine of judicial estoppel is inapplicable in this case.

First, we are not convinced that the Division's positions are "clearly inconsistent." By arguing that disgorgement related to trading in the Corporate Accounts was available in the First Proceeding, the Division was not contending that it could not alternatively pursue a separate action. The Division argued in the First Proceeding that the New Evidence showed that Pierce sold

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81 *Morgan v. Gonzales,* 495 F.3d 1084, 1092 (9th Cir. 2007); *see also Hulsey*, 22 F.3d at 1489 (equitable estoppel against the government applies "only when it does not frustrate the purpose of the statutes expressing the will of Congress or unduly undermine the enforcement of the public laws").

82 *Heckler v. Cmty. Health Servs. of Crawford County, Inc.*, 467 U.S. 51, 60 (1984).

83 *Reed Elsevier, Inc. v. Muchnick*, 559 U.S. 154, 170 (2010) (quoting *New Hampshire v. Maine*, 532 U.S. 742, 750 (2001)).

84 *New Hampshire*, 532 U.S. at 750–51.

Lexington shares through the Corporate Accounts and that he should therefore be required to disgorge the total net proceeds he received from the Lexington trades. But the Division never took the position before the law judge in the First Proceeding that disgorgement related to trading in the Corporate Accounts would be available *only* in that proceeding. When the law judge in the First Proceeding found that allegations regarding Pierce's unregistered trades in the Corporate Accounts went beyond the scope of the First OIP, it was not inconsistent for the Division to pursue additional disgorgement through the available alternative of bringing a separate action.

Furthermore, even if the Division's positions were clearly inconsistent, judicial estoppel is inapplicable because the Division failed to persuade the law judge in the First Proceeding to accept its position.[85] The First ID declined the Division's request to order disgorgement related to Pierce's trading in the Corporate Accounts because the law judge concluded that the Corporate Account transactions were beyond the scope of the First OIP. There is no threat to the integrity of the adjudication process, therefore, for the Division to leave unchallenged the law judge's decision in the First Proceeding while pursuing an alternative route to disgorgement in the current proceeding.[86] Accordingly, the doctrine of judicial estoppel is simply inapplicable here.

E. The Division did not waive its claim to additional disgorgement.

Pierce's waiver defense is likewise without merit. Pierce insists that the Division has waived its claim to additional disgorgement by failing to appeal the First ID. "[W]aiver is the 'intentional relinquishment or abandonment of a known right.'"[87] The party asserting waiver bears

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85 *Reed Elsevier, Inc.*, 559 U.S. at 170 (concluding that judicial estoppel did not apply because the district court did not adopt the party's jurisdictional argument and accepting that party's arguments "thus cannot create inconsistent court determinations in their favor" (internal quotation marks omitted)); *New Hampshire*, 532 U.S. at 750-751 ("Absent success in a prior proceeding, a party's later inconsistent position introduces no risk of inconsistent court determinations, and thus poses little threat to judicial integrity." (internal citations and quotation marks omitted)); *see also Pakovich v. Broadspire Servs., Inc.*, 535 F.3d 601, 605 n.2 (7th Cir. 2008) ("[O]ne of the requirements for judicial estoppel to apply is that the party to be estopped must have prevailed upon the first court to adopt the position." (internal quotation marks omitted)); *Webb v. ABF Freight Sys., Inc.*, 155 F.3d 1230, 1242 n.16 (10th Cir. 1998) ("[O]ne of the elements of this doctrine is that the party against whom estoppel is asserted must have prevailed on the basis of his contradictory position in the prior proceeding."); *Gens v. Resolution Trust Corp.*, 112 F.3d 569, 572 (1st Cir. 1997) ("Judicial estoppel is not implicated unless the first forum *accepted* the legal or factual assertion alleged to be at odds with the position advanced in the current forum.").

86 *See Stevens Technical Servs., Inc. v. SS Brooklyn*, 885 F.2d 584, 588–89 (9th Cir. 1989) (holding that judicial estoppel was inapplicable when the plaintiff asserted one position in good faith, lost, and abided by that decision in bringing the second action).

87 *United States v. Olano*, 507 U.S. 725, 733 (1993) (quoting *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938)).

the burden of showing that a waiver has occurred.[88] Pierce has failed to show that, by not appealing the First ID, the Division intentionally gave up its claim to additional disgorgement. As already discussed, because the Division had the option of pursuing the disgorgement of the profits related to the Corporate Account transactions by bringing a separate action, the mere failure of the Division to appeal the First ID does not evince an intent to abandon its claim to additional disgorgement.

F. Allowing the Second Proceeding does not violate Pierce's right to due process.

There is no merit to Pierce's argument that the Commission violated his due process rights by failing to pursue alternative paths under its Rules of Practice in the First Proceeding for the claims based on unregistered trading in the Corporate Accounts. Pierce contends that, under the Rules of Practice, the Division "could have asked the Commission to review and reverse or modify" the First ID, or it could have "moved the first hearing officer or the Commission to amend the [First] OIP to explicitly include the Newport/Jenirob disgorgement claim."[89] Alternatively, Pierce asserts, the Commission could have, on its own initiative, taken up the matter for review, or accepted and considered the New Evidence for any purpose, or ordered further consideration of the request for disgorgement based on trading in the Corporate Accounts. Because the Division and the Commission failed to do any of these things, Pierce asserts, the First ID became the final decision of the Commission, and he has a protected interest in its finality that would be denied if the Commission allowed a second proceeding against him based on the § 5 charges related to trading in the Corporate Accounts.

We find no due process violation here. Pierce's due process argument is simply a repackaging of his erroneous argument that estoppel or res judicata bars the Second Proceeding because the Division did not appeal the law judge's ruling that the OIP in the First Proceeding did not extend to claims based on illegal unregistered trading in the Corporate Accounts or seek leave to amend the OIP to include such charges. As we explained in rejecting those arguments, although Commission rules would have permitted the Division to appeal or request amendment of the OIP, the Division was not required to pursue either course, and its decision not to do so does not give Pierce any protected interest in not facing the § 5 charges based on the Corporate Accounts in the Second Proceeding.

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88 31 C.J.S. *Estoppel and Waiver* § 287.

89 Pierce acknowledges that, by its motion to admit the New Evidence, the Division "did effectively move to amend under Rule [of Practice] 200(d)(2), without labeling the motion precisely as such." Because the law judge cited the limitations on her authority to amend the First OIP in her ruling on the motion, there is no reason to think a motion made explicitly under Rule 200(d)(2) would have had a different outcome. *See supra* note 49 (discussing Rule of Practice 200(d)(2)).

IV.

A. Cease-and-desist relief is warranted in the public interest.

Section 8A(a) of the Securities Act authorizes the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" that Act or any rule thereunder.[90] In determining whether a cease-and-desist order is warranted, we consider a wide variety of factors: whether there is a reasonable likelihood of future violations,[91] how serious the violations are, whether the violations are isolated or recurrent, what state of mind the respondent had in committing the violations, to what extent the respondent recognizes the wrongful nature of his or her conduct, how recent the violations are, whether the violations caused harm to investors or the marketplace, whether the respondent will have the opportunity to commit future violations, and what remedial function the cease-and-desist order would serve in the overall context of any other sanctions sought in the same proceeding.[92] Our inquiry is flexible, and no single factor is dispositive.[93]

Pierce's violations were very serious. He reaped millions of dollars in profits by selling shares of stock without registration, causing harm to investors and the marketplace by depriving investors of the full disclosure that would have allowed them to make informed investment decisions.[94] The misconduct was both recurrent and long-lasting, consisting of numerous sales made over an eight-month period. Pierce's concealment of his involvement in these sales shows a high degree of scienter, and he shows no recognition that his conduct was wrongful. Based on Pierce's disciplinary history, the § 5 violations at issue, and Pierce's lack of contrition, we find there is a significant likelihood of future violations. We recognize that Pierce is already subject to the cease-and-desist order against violations of § 5 issued in the First Proceeding,[95] and this

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[90] 15 U.S.C. § 77h-1(a).

[91] The required showing of a risk of future violations is significantly less than that required for an injunction, and "in the ordinary case, a finding of a past violation is sufficient to demonstrate a risk of future ones." *KPMG Peat Marwick, LLP*, 54 S.E.C. 1135, 2001 SEC LEXIS 98, at *114 (Jan. 19, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002).

[92] *Id.* at *100-17.

[93] *Id.* at *116. Pierce does not specifically challenge the imposition of the cease-and-desist order in this case.

[94] *See supra* text accompanying note 26 (quoting *SEC v. Ralston Purina Co.*, 346 U.S. at 124).

[95] We also recognize that the misconduct at issue in this proceeding occurred before the cease-and-desist order had been issued in the First Proceeding.

lessens the remedial impact of another such order. Nonetheless, taking all these factors together, we find that a cease-and-desist order is in the public interest.[96]

B. Pierce is jointly and severally liable for disgorgement of the trading proceeds at issue.

Section 8A(e) of the Securities Act authorizes the Commission to order disgorgement in cease-and-desist proceedings brought under the Securities Act.[97] Disgorgement is an equitable remedy designed to deprive a violator of wrongfully obtained profits and to deter others from engaging in similar misconduct.[98] The Division must make a reasonable approximation of the amount of unjust enrichment that results from the violations in question, but the burden then shifts to the respondent to show that the Division's figure is unreasonable.[99]

The Division's calculation shows the trading profits from the sales of unregistered Lexington shares in the Corporate Accounts at issue to be $7,247,635.75. These proceeds are attributable as ill-gotten gains to Pierce, as the beneficial owner of the assets in those accounts. We find this a reasonable approximation of Pierce's ill-gotten gains, and that Pierce should be held jointly and severally liable for $5,264,466.64 of this amount with Newport and for $1,983,169.11 of this amount with Jenirob, based on the respective trading proceeds of each entity.[100]

Pierce does not deny that he is the beneficial owner of the assets of Newport, nor does he contend that Newport's receipt of Lexington trading profits was of no benefit to him.[101] The Hypo

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[96] *See Hunter Adams*, 58 S.E.C. 937, 2005 SEC LEXIS 225, at *4 (Feb. 1, 2005) (noting that "if violations of the same statutory provisions are based on different conduct in each proceeding, then awarding relief in each proceeding would not necessarily be duplicative.").

[97] 15 U.S.C. § 77h-1(e).

[98] *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989); *see also, e.g.*, *SEC v. M&A West, Inc.*, 538 F.3d 1043, 1054 (9th Cir. 2008) (affirming disgorgement ordered by district court "to ensure that [§ 5 violator] is not allowed to benefit from his unlawful conduct").

[99] *See, e.g.*, *SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010) (citing and quoting *First City Fin. Corp.*, 890 F.3d at 1232); *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 2006) (where disgorgement calculations cannot be exact, risk of uncertainty "'should fall on the wrongdoer whose illegal conduct created that uncertainty'" (quoting *SEC v. Patel*, 61 F.3d 167, 140 (2d Cir. 1995)).

[100] The law judge ordered disgorgement of this amount solely as to Pierce, without accounting for the fact that Newport and Jenirob have already been held liable for their respective amounts of the trading proceeds. *See supra* note 24. Our decision here corrects that error.

[101] Pierce has not explained why it would matter for purposes of this case whether he was the beneficial owner of Newport and Jenirob, as the law judge found in the First ID, or whether, as the Hypo Bank records show, he was the beneficial owner of the assets in the Newport and Jenirob Accounts.

(continued...)

Bank records show that Pierce was the beneficial owner of the assets of Jenirob, so Jenirob's receipt of Lexington trading profits also benefitted him. But he argues that it is not enough for the Division to show that he benefitted from the presence of the Lexington proceeds in the Corporate Accounts. Instead, he contends, the Division must show that he, rather than Newport and Jenirob, actually received those proceeds—that is, that Newport or Jenirob paid some or all of their sale proceeds to him.

The law does not support Pierce's position. For purposes of disgorgement there is no meaningful distinction between receiving funds outright and having funds paid into an account one controls. As beneficial owner of the assets in the Corporate Accounts, Pierce could have ordered the sales proceeds paid to himself at any time. Whether he did so or not does not affect the disgorgement analysis.

The court's reasoning in *SEC v. Warde* is instructive.[102] Warde argued that he should not be required to disgorge trading profits "attributable to third parties."[103] The court rejected his argument, finding that a trust (of which he was the sole present beneficiary) and Warde's wife (over whose account Warde "exercised complete control") were not "truly third parties."[104] Here, similarly, Pierce's beneficial ownership of the assets in the Corporate Accounts establishes that Pierce is not "truly a third party" for purposes of disgorgement; the trading profits in the Corporate Accounts are already Pierce's money, and he should be required to disgorge them.

Moreover, even if the assets in the Corporate Accounts were not already Pierce's money, his argument would fail because in cases involving joint and several liability, individuals may be

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(...continued)

On November 14, 2011, the Division sought to introduce additional evidence in the form of four documents. The Division contends that three of these documents concern the interests of Pierce, his wife, and his daughter in two trusts that beneficially owned Newport, and that the fourth document constitutes an admission by Pierce that he received a personal financial benefit from assets held by Newport. Pierce opposes the Division's motion, arguing that this new evidence "is neither new nor probative of any issue in the case."

Commission Rule of Practice 452 permits the Commission to allow the submission of additional evidence on appeal if the moving party shows with particularity both (a) that the new evidence is "material" and (b) that there were "reasonable grounds for failure to adduce such evidence previously." 17 C.F.R. § 201.452. The new documents submitted by the Division are duplicative of other materials already in the record, and we therefore decline to accept them as evidence. *See, e.g., Richard A. Neaton*, Exchange Act Release No. 65598, 2011 SEC LEXIS 3719, at * 27-28 (Oct. 20, 2011) (declining to admit additional evidence that "merely duplicates" the substance of evidence already in the record).

102 151 F.3d 42 (2d Cir. 1998).

103 *Id.* at 49.

104 *Id.*

ordered to disgorge the entire amount of ill-gotten gains whether or not they received any of those gains. As the court observed in *SEC v. Platforms Wireless International Corp.*, "'[w]here two or more individuals or entities collaborate or have a close relationship in engaging in the violations of the securities laws, they have been held jointly and severally liable for the disgorgement of illegally obtained proceeds.'"[105]

Here, the relationship between Pierce and the two companies, Newport and Jenirob, with respect to the § 5 violations could hardly have been closer: Pierce directed the violative trades from the Newport and Jenirob Accounts. And where joint and several liability is found, courts routinely order disgorgement of the entire amount of ill-gotten gains jointly and severally from individuals who received only part of the proceeds of the wrongdoing, or did not receive any of the proceeds at all. In *SEC v. First Pacific Bancorp*, for example, a company's chief executive officer who collaborated in fraudulent misconduct was held jointly and severally liable with the company for proceeds obtained by the company despite his argument that he did not receive the proceeds himself.[106] In *SEC v. Platforms Wireless International Corp.*, the court held the chairman and chief executive officer of a company, who "orchestrated the unlawful transactions" and "had control of the proceeds" of sales that violated § 5, jointly and severally liable with the company for disgorgement of one hundred percent of the sale proceeds notwithstanding the officer's argument that he did not "personally benefit" from the violations by receiving money or other remuneration

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[105] 617 F.3d 1072, 1098 (9th Cir. 2010) (quoting *First Pac. Bancorp*, 142 F.3d at 1191); *see also, e.g.*, *SEC v. Whittemore*, 659 F.3d 1, 10-11 (D.C. Cir. 2011) (imposing joint and several liability on one who closely collaborated in fraudulent scheme); *SEC v. Universal Express, Inc.*, 438 F. App'x 23, 26 (2d Cir. 2011) (imposing joint and several liability based on collaboration in violative conduct); *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455-56 (3d Cir. 1997) (imposing joint and several liability on defendants who "all collaborated in a single scheme to defraud" and who "enjoyed a 'close relationship' with each other").

Pierce relies on *M&A West*, 538 F.3d at 1054, and *VanCook v. SEC*, 653 F.3d 130 (2d Cir. Aug. 8, 2011), arguing that, in both cases, the disgorgement ordered was for less than the entire proceeds of the wrongful conduct. But those cases do not involve joint and several liability for the disgorgement in question; they are therefore inapposite. *Compare SEC v. Global Express Capital Real Estate Inv. Fund I, LLC*, 289 F. App'x 183, 190 (9th Cir. 2008) (holding that an individual could not be ordered to disgorge ill-gotten gains retained by certain entities because the funds retained by the entities could not be considered her personal ill-gotten gains and the entities had not been held jointly and severally liable for disgorgement with the individual).

[106] 142 F.3d at 1191-92. Pierce argues that *First Pacific Bancorp* is distinguishable because the defendant in that case received substantial personal benefit, including but not limited to excessive compensation. Although the CEO in *First Pacific Bancorp* personally received payment of some of the ill-gotten gains, the Ninth Circuit does not require a showing of personal receipt of any of the ill-gotten gains as a prerequisite for joint and several liability for all such gains. *See Platforms Wireless*, 617 F.3d at 1098 & n.15.

as a result of the misconduct.[107] The court reasoned that it was "not inequitable to require [the respondent] jointly to share the burden of restoring the illegally obtained monies, even if he did not allocate them to himself."[108] And in *SEC v. Hughes Capital Corp.*, the court ordered a defendant who collaborated with others in a scheme to inflate the price of stock jointly and severally liable for disgorgement of all the proceeds obtained in the scheme even though the defendant argued that she received only a portion of the proceeds.[109]

Pierce's argument in his petition for review that disgorgement is ***"limited to actual profits obtained by wrongdoing"*** (emphasis in original) is simply another way of phrasing his contention that he cannot be forced to disgorge money that he did not personally receive. But the cases he cites do not focus on whether someone "obtained" ill-gotten gains, in the sense of having those gains paid directly into one's bank account rather than (as here) having the gains in accounts over which one exercises control. Instead, they stand for the proposition that the total amount of disgorgement ordered in a proceeding may equal, but may not exceed, the amount of ill-gotten gains generated by the wrongful conduct. In *SEC v. Blatt*, for example, the court held that the defendants could be ordered to disgorge the amount by which they profited from wrongdoing (plus interest), but that they could not additionally be ordered to pay as "disgorgement" amounts required for the compensation and expenses of a trustee in collecting and distributing the disgorged funds.[110] In a similar vein, the court in *SEC v. Manor Nursing Centers, Inc.* held that the proceeds of violative activity were subject to disgorgement, but the income earned by investing those proceeds was not (because ordering payment to the court of the latter would be an impermissible penalty assessment).[111] And in *SEC v. Hateley*, the court held that where an agent of a broker-dealer had already been ordered to disgorge sales commissions that he received as a result of wrongful conduct, officers and directors of the firm could not be separately required to disgorge those same commissions, since that would result in disgorgement exceeding the amount of ill-gotten gains.[112] Here, on the other hand, we order disgorgement only of the proceeds of the unregistered Lexington sales. And because liability is to be joint and several, the amount disgorged will not exceed the ill-gotten gains.

Although Pierce acknowledges that where antifraud violations are at issue, a violator may be required to disgorge ill-gotten proceeds that the violator did not personally receive, he characterizes this as an exception to the alleged rule on which he relies, and argues that it has been applied "particularly when in the absence of vicarious (joint and several) liability for disgorgement, wrongdoers would escape liability altogether." But § 5 violators have been held

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[107] 617 F.3d at 1096-99.

[108] *Id.* at 1098.

[109] 124 F.3d at 455-56.

[110] 583 F.2d 1325, 1335-36 (5th Cir. 1978).

[111] 458 F.2d at 1104-05.

[112] 8 F.3d 653, 655-56 (9th Cir. 1993).

jointly and severally liable for disgorgement of the proceeds of the unregistered transactions where none of the defendants were found to have committed antifraud violations.[113]

Finally, relying principally on *SEC v. First City Financial Corp.*,[114] Pierce argues that disgorgement may not be used punitively.[115] But the court's observation in that case that disgorgement may not be used punitively was made in the context of supporting the court's conclusion there that the equitable power of disgorgement may be exercised "only over property causally related to the wrongdoing."[116] The trading profits in the Corporate Accounts are unquestionably related to the § 5 violations at issue here.

An appropriate order will issue.[117]

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, STEIN and PIWOWAR).

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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[113] *See, e.g.*, *SEC v. Friendly Power Co. LLC*, 49 F. Supp. 2d 1363, 1373 (S.D. Fla. 1999); *see also SEC v. Calvo*, 378 F.3d 1211, 1215 (11th Cir. 2004) (imposing joint and several liability for disgorgement of proceeds of § 5 violations on defendant who was found to have committed only § 5 violations, even though other defendant was found to have committed both antifraud violations and § 5 violations, and finding that the principle that joint and several liability in securities cases is appropriate where parties have a close relationship or collaborate in the violations "holds true even where one defendant is more culpable than another").

[114] 890 F.2d 1215.

[115] Pierce also cites *M&A West,* in which the court required defendant Medley to disgorge the cash payments and profits he received as a result of § 5 violations rather than the entire proceeds. 538 F.2d at 1054. But as noted above, *M&A West* is distinguishable because disgorgement in that case was not ordered jointly and severally.

[116] 890 F.2d at 1231.

[117] 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 ACT OF 1933
Release No. 9555 / March 7, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71664 / March 7, 2014

Admin. Proc. File No. 3-13927

In the Matter of

GORDON BRENT PIERCE
c/o William F. Alderman
Shireen Qaru
Orrick, Herrington & Sutliffe LLP
San Francisco, CA 94105

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Gordon Brent Pierce cease and desist from committing or being a cause of any violations or future violations of §§ 5(a) and 5(c) of the Securities Act of 1933; and it is further

ORDERED that Gordon Brent Pierce disgorge $5,264,466.64, jointly and severally with Newport Capital Corporation, plus prejudgment interest of $3,034,239.55, such prejudgment interest calculated beginning from October 1, 2004, with such interest continuing to accrue on all funds owed until they are paid, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Gordon Brent Pierce disgorge $1,983,169.11, jointly and severally with Jenirob Company Ltd., plus prejudgment interest of $1,176,869.27, such prejudgment interest calculated beginning from July 1, 2004, with such interest continuing to accrue on all funds owed until they are paid, in accordance with Commission Rule of Practice 600.

Payment of the disgorgement and prejudgment interest shall be made not later than twenty-one days after service of this order. Payment shall be made by United States postal money order, certified check, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying Respondent and Administrative Proceeding No. 3-13927, shall be mailed or delivered by hand to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South

MacArthur Bld., Oklahoma City, OK 73169. A copy of the cover letter and instrument of payment shall be sent to Steven D. Buchholz, counsel for the Division of Enforcement, San Francisco Regional Office, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104.

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. 71668 / March 7, 2014

Admin. Proc. File No. 3-14981

In the Matter of

ROSS MANDELL

ORDER SUMMARILY AFFIRMING INITIAL DECISION IN PART AND IMPOSING REMEDIAL SANCTIONS

Ross Mandell, former president, chief executive officer, and majority shareholder of Sky Capital LLC (f/k/a Granta Capital LLC), was convicted of securities fraud, wire fraud, mail fraud, and conspiracy. Following his conviction, the Commission instituted a follow-on administrative proceeding pursuant to Section 15(b) of the Securities Exchange Act of 1934 to determine whether the statutory predicate for an administrative remedy was satisfied and whether remedial action would serve the public interest. The initial decision of an administrative law judge in the follow-on proceeding barred Mandell from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization (NRSRO).[1]

Mandell filed a petition for review by the Commission, and the Division of Enforcement filed a motion for summary affirmance of the initial decision. We have reviewed the record of action before the law judge *de novo*, as well as the petition for review and the motion for summary affirmance. We also take official notice of Mandell's disciplinary history information on BrokerCheck.[2]

I. We summarily affirm the law judge's findings with respect to Mandell's conviction and the law judge's holding with respect to the prospective nature of collateral bars.

The law judge found that on July 26, 2011, a jury found Mandell guilty of securities fraud, mail fraud, wire fraud, and conspiracy to commit those offenses. The law judge also found that

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1 *Ross Mandell*, Initial Decision Release No. 478, 2013 WL 30144 (Jan. 3, 2013).

2 BrokerCheck is an electronic database maintained by FINRA and available at www.finra.org/Investors/ToolsCalculators/BrokerCheck (last checked March 5, 2014). *See* 17 C.F.R. § 201.323 (rule of practice relating to official notice).

"[e]ach count in Mandell's conviction . . . is an independent and alternative basis" for proceeding under Exchange Act Section 15(b).[3] Under Rule of Practice 411, we may summarily affirm an initial decision, in whole or in part, when we conclude that further oral or written argument regarding issues raised in the initial decision is not warranted.[4] Based on our review, we find that the law judge's findings regarding Mandell's conviction are correct and do not warrant further argument. We summarily affirm and adopt these findings.

We also affirm the law judge's holding with respect to the prospective nature of collateral bars. The events giving rise to Mandell's conviction occurred prior to the 2010 enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which amended Exchange Act Section 15(b)(4)(B) to authorize bars from associating with any investment adviser, municipal securities dealer, municipal advisor, transfer agent, or NRSRO.[5] Mandell challenges the collateral bars the law judge imposed, arguing that they are impermissibly retroactive and "prohibit [him] from associations that [he has] never had, never sought, and never even contemplated."[6] In seeking summary affirmance of the law judge's decision, the Division argues that *John W. Lawton* resolved the retroactivity issue as a matter of law.[7] We agree and find that the law judge appropriately followed our holding in *Lawton*, which stated that collateral bars are available as prospective

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[3] *Mandell*, 2013 WL 30144, at *8 n.7 (further stating that "[e]ven if . . . the Second Circuit Court of Appeals vacates Mandell's securities fraud conviction but upholds his convictions on the other three counts, this action may still be maintained"); *see* 15 U.S.C. § 78o(b)(4)(B)(i), (ii), (iv); *cf. Eric S. Butler*, Securities Exchange Act Release No. 65204, 2011 WL 3792730 (Aug. 26, 2011) (follow-on remedies imposed following convictions for conspiracy to commit securities fraud, wire fraud, and securities fraud, even though the respondent's securities fraud conviction was later reversed on appeal). Mandell appealed his conviction to the United States Court of Appeals for the Second Circuit, where his appeal is still pending. *United States v. Mandell*, No. 12-2090 (2d. Cir. argued May 2, 2013). The Second Circuit granted Mandell bail pending its consideration of his appeal.

[4] 17 C.F.R. § 201.411(a) ("The Commission may affirm, reverse, modify, set aside or remand . . . , in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record."); *id.* at § 201.411(e)(2) ("The Commission may grant summary affirmance if it finds that no issue raised in the initial decision warrants consideration by the Commission of further oral or written argument.").

[5] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[6] Petition for Review at 2. Our analysis centers on Mandell's retroactivity argument, which is the focus of his petition for review. *See* Rule of Practice 411(d), 17 C.F.R. § 240.411(d) (stating that the Commission's review "shall be limited to the issues specified in the petition for review or the issues, if any, specified in the briefing schedule order").

Under Commission Rule of Practice 410(b), we deem any exception to the initial decision not stated in Mandell's petition for review waived. 17 C.F.R. § 201.410(b) (describing the Commission's discretion to deem "any exception to the initial decision not stated in the petition for review, or in a previously filed proposed finding . . . waived by the petitioner").

[7] Investment Advisers Act Release No. 3513, 2012 WL 6208750 (Dec. 13, 2012).

remedies under the securities laws and are not impermissibly retroactive. We conclude that these issues do not warrant further oral or written argument. Accordingly, pursuant to Rule of Practice 411(e)(2), we summarily affirm and adopt these findings.

II. We find, based on our independent review, that the public interest is served by barring Mandell from any association in the securities industry.

The Division seeks summary affirmance of the industry-wide bar against Mandell. We "will decline to grant summary affirmance upon a reasonable showing that a prejudicial error was committed in the conduct of the proceeding or that the decision embodies an exercise of discretion or decision of law or policy that is important and that the Commission should review."[8]

Based on our review of the initial decision, we conclude that summary affirmance of the bars imposed by the law judge would not be appropriate because further analysis articulating whether it is in the public interest to impose the bars sought by the Division is warranted as an exercise of discretion on which we have an interest in articulating our own views. Although we agree with the Division that the initial decision correctly followed the legal holding in *Lawton*, determining whether a bar serves such a remedial purpose in any given case embodies an exercise of discretion and is not solely a question of law.

In order for the Commission to adopt and affirm a law judge's decision to impose an industry-wide bar, the law judge's analysis must explain, based on the facts and circumstances presented in that case, why such bars are in the public interest. As *Lawton* explained, in deciding whether the public interest warrants a collateral bar, the Commission (or an administrative law judge) should "consider the record evidence [presented in that case] to determine whether such a remedy is necessary or appropriate to protect investors and markets . . . ."[9] The decision should "review each case on its own facts" to make findings regarding the respondent's fitness to participate in the industry in the barred capacities.[10] The analysis need not include a "'ritualistic incantation'

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8 Rule of Practice 411(e)(2), 17 C.F.R. § 201.411(e)(2); *see Andover Holdings, Inc.*, Exchange Act Release No. 68966, 2013 WL 653011 (Feb. 21, 2013) (summarily affirming law judge decision under Rule of Practice 411); *see also A-Power Energy Generation Systems, Ltd.*, Exchange Act Release No. 69439, 2013 WL 1755036 (Apr. 24, 2013) (summarily affirming initial decision in part and imposing remedial sanctions).

9 *Lawton*, 2012 WL 6208750, at *9.

10 *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005); *cf. also id.* at 290 (rejecting two-year suspension by finding that it was not "support[ed] . . . with findings and conclusions, and [the decision] provided no meaningful statement of the reasons or basis therefor in support of the discretion it exercised on [the] record"); *cf. also Paz v. SEC*, 566 F.3d 1172, 1175 (D.C. Cir. 2009) (noting the need for the Commission to be "'particularly careful to address potentially mitigating factors' when it affirms an order to expel a firm from the NASD").

regarding [the] remedial effect" of the bars, but it should be grounded in specific "findings regarding the protective interests to be served" by barring the respondent and the "risk of future misconduct."[11]

In this case, although the initial decision discussed the public interest factors in general terms, it did not sufficiently articulate why the facts and circumstances of this case warrant the industry-wide bars imposed or how such bars "protect the trading public from further harm" by this respondent.[12] We have an interest in further explaining why the bars serve the public interest in this case.

A. Mandell led an eight-year scheme that employed three different types of fraud.

We find that Mandell's conduct demonstrates his inability to observe investor protections and market integrity principles that apply throughout the securities industry. Mandell controlled two registered broker-dealers, The Thornwater Company, LP and Sky Capital LLC, and their employees.[13] He also controlled multiple companies ("Sky Capital companies") that issued securities that these broker-dealers offered to and traded for their customers. During the period at issue, two of these companies, Sky Capital Holdings Ltd (SKH) and Sky Capital Enterprises Inc. (SKE), issued securities that were listed for trading on the London Stock Exchange.

Between approximately 1998 and 2006, Mandell used the broker-dealers to engage in at least three types of fraudulent conduct. First, the scheme solicited millions of dollars from investors through fraudulent public and private securities offerings for the Sky Capital companies. Then, after SKH and SKE became publicly listed, Mandell encouraged fraudulent and high pressure trading tactics to manipulate the market price for the SKH and SKE securities. He then used these manipulated stock prices to promote additional fraudulent offerings. Finally, Mandell used funds from the fraudulent offerings and trading practices to enrich himself, incentivize brokers to further the scheme, and placate victims of earlier offerings.

Offering fraud. Mandell and others acting at his direction misled investors about information that went to the heart of any investment decision in the Sky Capital securities, *i.e.*, how the invested funds had been and would be used, expected returns, and the value of the securities.

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11 *McCarthy*, 406 F.3d at 189 & 190; *cf. also Paz*, 566 F.3d at 1175 (noting that the courts "do not require the Commission to explain itself by reference to 'some mechanical formula'" (quoting *Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1113 (D.C. Cir. 1988)).

12 *Cf. James Gerard O'Callaghan*, Exchange Act Release No. 57840, 2008 WL 2117162, at *11 (Dec. 10, 2009) (remanding NYSE disciplinary proceeding and directing the NYSE to "address the protective interests to be served by removing O'Callaghan from the [trading] floor, the mitigating factors presented in the record, and any other factors related to whether a suspension is appropriately remedial and not punitive").

13 This summary of Mandell's conduct draws from the allegations in the superseding indictment underlying his criminal conviction. *United States v. Ross H. Mandell*, No 1:09-cr-662 (S.D.N.Y Dec. 14, 2010) (the "Indictment").

They fraudulently promised investors that imminent "liquidity events" would dramatically enhance the value of the securities. But as the district court stated, these "dulcet words were not opinions, or good faith estimates, or optimistic predictions of future events; they were lies."[14] Moreover, Mandell systematically used legitimate broker-dealer business to recruit investors for the scheme; for instance, brokers under his control often initially sold non-Sky Capital securities but later encouraged the investors to exchange their shares for fraudulent Sky Capital securities.

Market manipulation. After SKH and SKE securities began publicly trading in 2002 and 2004 respectively, Mandell and others acting at his direction manipulated the markets for the securities. They artificially inflated the market prices by enforcing firm-wide "no net sales" policies and practices to suppress sell orders without matching buy orders. Their practices included high-pressure tactics to discourage customers from selling their SKH and SKE holdings and in some cases simply refusing to execute customers' sale orders. Brokers also executed corresponding—and unauthorized—purchases for other customers' accounts and manipulated the order, timing, and execution of trades. For instance, the brokers parked stock in customer accounts (often without customer consent) and used error accounts to prevent sales from affecting the stock price.

Mandell used the artificially inflated stock prices created by this manipulative trading to promote additional private SKE and SKH offerings. Maintaining the artificially inflated market prices was a key to promoting these private offerings. In order to persuade investors to purchase securities in private offerings when the stock was already available on the secondary market, Mandell and others acting at his direction told investors that the private placements offered discounts from the market prices (even as the brokers were fraudulently inflating these prices). These investors were not told that there was no actual discount for the private placements because the SKE and SKH market prices were artificially inflated.

Misuse of offering and trading proceeds. Mandell used the proceeds from these fraudulent offering and trading activities to enrich himself and his co-conspirators through payments and reimbursements for non-business personal and entertainment expenses. These payments were not disclosed to investors who purchased securities in the fraudulent offerings or to customers who had accounts with brokers engaged in manipulative trading. Instead, Mandell concealed them as loans, advances, special bonuses, and consulting fees. As investors lost money in the scheme, Mandell also used the proceeds from later offerings to placate them.

B. An industry-wide bar is in the public interest.

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 conduct, and the likelihood that the respondent's occupation

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[14] *United States v. Ross H. Mandell*, No 1:09-cr-0062, at 6 (S.D.N.Y Nov. 2, 2011) (the "Order") (denying motions for acquittal or new trial).

could present opportunities for future violations.[15] Our "inquiry into . . . the public interest is a flexible one, and no one factor is dispositive."[16]

1. ***Egregiousness of the respondent's actions.***

Mandell's fraudulent scheme was egregious and violated bedrock antifraud principles that apply throughout the securities industry, including the "philosophy of full disclosure" of accurate and non-misleading information to investors;[17] the obligation to deal fairly with investors;[18] and the prohibition on self-dealing.[19] Mandell was convicted for scienter-based conduct that violated antifraud prohibitions that apply to all securities professionals.[20]

Moreover, rather than playing a minor role in the scheme, Mandell was its leader and driving force.[21] He used his control of the broker-dealers, their employees, and the Sky Capital companies

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15 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

16 *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *15 (Dec. 21, 1007), *petition denied*, 334 F. App'x 334 (D.C. Cir. 2009) (per curiam).

17 *Santa Fe Indus. v. Green*, 430 U.S. 462, 477 (1977) (explaining that the "fundamental purpose" of the Exchange Act is to "substitute a philosophy of full disclosure for the philosophy of caveat emptor" (internal citations omitted)); *SEC v. Capital Gains*, 375 U.S. 180, 186 (1963) (stating that a "fundamental purpose, common to [the securities law] statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standards of business ethics in the securities industry").

18 *See Randall v. Loftsgaarden*, 478 U.S. 647, 664 (1986) (stating that the Exchange Act was intended "to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions").

19 *See Capital Gains*, 375 U.S. at 201 (finding that disinterested advice is a necessary component of the "high standards of business morality exacted by our laws regulating the securities industry"); *Lawton*, 2012 WL 6208750, at *11 (noting that the "industry relies on the fairness and integrity of all persons associated with each of the professions covered by the collateral bar to forego opportunity to defraud and abuse other market participants"); Insider Trading and Securities Fraud Enforcement Act Section 7, 15 U.S.C. § 78b note (noting the "important national interest in maintaining fair and orderly securities trading, assuring the fairness of securities transactions and markets and protecting investors").

20 *See Tzemach David Netzer Korem*, Exchange Act Release No. 70044, 2013 WL 3864511, at *7 (July 26, 2013) (noting that collateral bar was appropriate when violations were not "based solely on [respondent's] status as a transfer agent" and "apply broadly to the conduct of all participants in the securities industry").

21 *Cf. McCarthy*, 406 F.3d at 189 (stating that the sanctions analysis must sufficiently address mitigating factors, such as the respondent's role as a relatively minor participant in a larger trading scheme and the short duration of his violations).

to organize and execute a conspiracy to defraud investors. After adopting firm-wide policies to incentivize offering fraud and manipulative trading, Mandell used the money generated from these fraudulent practices to enrich himself and his co-conspirators. For example, Mandell arranged large corresponding block purchases and sales of Sky Capital securities to generate a "spread" in prices, which he then used to compensate the brokers for their manipulative trading.

2. *Isolated or recurrent nature of the violation.*

Mandell's involvement in the scheme was not a momentary lapse in judgment. The scheme continued for approximately eight years through two broker-dealers, defrauded more than 250 investors, and resulted in a twelve year prison term, a $50 million forfeiture order, and a $24 million restitution order.[22]

3. *Degree of scienter.*

Mandell's convictions rest on findings that he acted "unlawfully, willingly, and knowingly" when he engaged in securities fraud, wire fraud, mail fraud, and conspiracy to commit those offenses. He acted with a high degree of scienter in planning and executing this complex web of fraud through firm-wide policies and incentive payments.[23] And his attempts to conceal his leadership of the scheme are further evidence that he acted with a high degree of scienter. He concealed his control of Thornwater by relying on "lie[s] to regulators about who was in charge" of the firm, and caused Thornwater to enter into a "sweetheart—self-dealing contract" with him while he acted as an undisclosed principal.[24] He also misled investors about his control of the scheme by holding himself out as merely a broker-dealer and investment banker, and falsely stating in written marketing materials that he would not "manage[] . . . Sky Capital's securities business or the training [or] supervision of persons associated with Sky Capital . . . ."[25]

Mandell also demonstrated a high degree of scienter by disguising the fraudulent payments fueling the scheme. He mischaracterized self-enriching payments and reimbursements for personal expenses as consulting fees and authorized and directed excessive payments to brokers that were disguised as advances, loans, and special bonuses.[26] When he compensated investors for their losses, Mandell disguised these payments as consulting fees. By seeking to minimize his role and

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22 Although Mandell's restitution order did not cover any of the other criminal defendants, it stated that his "liability for restitution shall be joint and several with that of any other defendant ordered to make restitution . . . ." As noted, Mandell has been released on bail pending his Second Circuit appeal. *See supra* note 3.

23 *See 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).

24 Order at 7.

25 Indictment at 11.

26 Indictment at 19.

disguise these payments, Mandell demonstrated that he knew that these practices were wrongful and that such deception was necessary to attract investors, avoid regulatory scrutiny, and prevent discovery of his fraud.

4. *Respondent's recognition of the wrongful nature of his conduct.*

During the proceeding below, Mandell did not offer assurances against future violations, recognize the wrongful nature of his conduct, address the *Steadman* factors despite prompting from the law judge to do so, or articulate any mitigating factors. Although Mandell expressed remorse during the criminal sentencing, he also sought to deflect blame by "accus[ing] witnesses of lying and stat[ing] that he was fighting 'lies, bad decisions, innuendo, [and] corruption.'"[27] We do not find any other factors that mitigate the seriousness of Mandell's fraud.[28]

5. *Likelihood of opportunities for future violations.*

Mandell's attempts to deflect responsibility for his fraudulent scheme demonstrate either a fundamental misunderstanding of his responsibilities as a securities professional or that he "hold[s] those obligations in contempt."[29] In either case, these attempts reveal a serious risk he would commit further misconduct if permitted in any area of the industry. Each area of the industry covered by the collateral bar "presents continual opportunities for [similar] dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence."[30] By organizing conduct that would be unlawful in any area of the industry and hiding and downplaying his responsibility for a multi-million dollar fraudulent scheme, Mandell demonstrates "an attitude toward regulatory oversight that is fundamentally incompatible with [basic] principles of investor protection and with association in any capacity covered by the collateral bar."[31]

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27 *Mandell*, 2013 WL 30144, at *7.

28 During the proceeding before the law judge, Mandell focused on the Second Circuit's decision to grant him bail pending his criminal appeal and argued that this decision put his criminal conviction in question. If he successfully overturns the criminal verdicts in his appeal, Mandell may seek modification of the sanctions imposed here. *See Jimmy Dale Swink Jr.*, Exchange Act Release No. 36042, 52 S.E.C. 379 (Aug. 1, 1995). But his pending appeal is not a mitigating factor.

29 *Barr Fin. Group, Inc.*, Advisers Act Release No. 2179, 56 S.E.C. 1243, 2003 WL 22258489, at *7 (Oct. 2, 2003).

30 *Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 WL 2790633, at *7 (Sept. 26, 2007); *see also Charles Phillip Elliot*, Exchange Act Release No. 31202, 50 S.E.C. 1273, 1992 WL 258850, at *3 (Sept. 17, 1992) (noting that the industry "presents many opportunities for abuse and overreaching"), *aff'd*, 36 F.3d 86 (11th Cir. 1994).

31 *Lawton*, 2012 WL 6208750, at *12.

Mandell's disciplinary history is an aggravating factor that strongly weighs in favor of an industry-wide collateral bar.[32] Before this scheme began Mandell was disciplined by the New York Stock Exchange for unauthorized trading, and he has been denied registration in three states.[33] When Sky Capital sought NASD membership, NASD expressly conditioned the firm's membership on its agreement that Mandell would not supervise the firm's other registered representatives. Sky Capital's private placement memorandum made similar assurances directly to investors about Mandell's non-supervisory role at the firm. We find collateral bars particularly appropriate when, as in this case, regulators have previously attempted to limit the respondent's association in the industry, and those regulatory restrictions did not dissuade the respondent from engaging in further misconduct.[34]

Mandell asserts that he has "never even contemplated" entering the securities industry in the capacities covered by the collateral bars. But given his past efforts to conceal his leadership of the fraudulent scheme and the previous false assurances to investors and regulators that his role would be limited, we find that this assertion is outweighed by the unacceptable risk that Mandell would seek to return to the industry in any capacity left open to him, exposing investors and the markets to further fraudulent conduct.

Accordingly, we find an industry-wide bar is appropriate in light of our obligation to "ensure honest securities markets, [and] thereby promot[e] investor confidence."[35] Collateral bars in this case will serve the public interest as a prospective remedy to "protect investors against fraud and . . . promote ethical standards of honesty and fair dealing" in the securities markets.[36]

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32 *Id.* at *13.

33 *See supra* note 2.

34 *See Korem*, 2013 WL 3864511, at *10 n.59 (noting that a long criminal history "compounds our concerns about [the respondent's] integrity and fitness and demonstrates that he poses a substantial threat to investors").

35 *United States v. O'Hagan*, 521 U.S. 642, 658 (1997).

36 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976); *see McCurdy v. SEC*, 396 F.3d 1258, 1265 (D.C. Cir. 2005) (finding that the purpose of a securities industry suspension in that case was "not to punish [the respondent], but rather to protect the public from his demonstrated capacity" for violative conduct).

Accordingly, it is ORDERED that the law judge's findings under Exchange Act Section 15(b) are summarily affirmed; and

It is further ORDERED that Mandell is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN): Commissioner PIWOWAR concurring in part and dissenting with respect to the bars from association with municipal advisors and nationally recognized statistical rating organizations; Commissioner GALLAGHER not participating.

Elizabeth M. Murphy

Elizabeth M. Murphy

Secretary

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the
Municipal Advisor + NRSRO
Bars

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 71666 / March 7, 2014

Admin. Proc. File No. 3-14700

In the Matter of

GREGORY BARTKO

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

Ground for Remedial Action

Former associated person of a registered broker-dealer was criminally convicted of conspiracy, mail fraud, and illegal sales of unregistered securities. *Held*, it is in the public interest to bar him from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

APPEARANCES:

Gregory Bartko, pro se.

Robert K. Gordon, for the Division of Enforcement.

Appeal filed: September 6, 2012
Last brief received: July 3, 2013

10a of 63

I.

Gregory Bartko was chief executive officer and chief compliance officer of Capstone Partners, L.C., a registered broker-dealer. On November 18, 2010, the United States District Court for the Eastern District of North Carolina (Western Division) entered a judgment of conviction against Bartko for conspiracy, mail fraud, and unregistered securities sales. On January 18, 2012, the Commission instituted a follow-on administrative proceeding to determine whether Bartko's conviction was a statutory basis for an administrative remedy and, if so, the appropriate remedial response.

On August 21, 2012, the administrative law judge found that the case presented no genuine issue as to any material fact and that the Division of Enforcement was entitled to summary disposition as a matter of law. He barred Bartko from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent, but declined to bar him from association with a municipal advisor or nationally recognized statistical rating organization (NRSRO). The law judge noted that those two forms of relief were authorized by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act,[1] and that Bartko engaged in the relevant misconduct before Dodd-Frank was enacted in 2010. The law judge found that, at that time, Bartko had a right to associate with a municipal advisor or NRSRO "approximating an 'immediate fixed right of present or future enjoyment'" and that such bars would be impermissibly retroactive.[2]

This appeal followed. We base our findings on an independent review of the record, except for those law judge findings that are not challenged in this appeal.

II.

Bartko specialized in securities law for approximately fifteen years and received his LL.M. in securities regulation from the Georgetown University Law Center in 1989.[3] He also held securities licenses and was chief executive officer and chief compliance officer of Capstone Partners, L.C. ("Capstone BD").[4] Bartko held himself out to investors as an investment banker

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

2 Quoting *Fernandez-Vargas v. Gonzales*, 548 U.S. 30, 44 n.10 (2006).

3 The evidence for this administrative proceeding includes documents adduced from the criminal case, including a superseding indictment returned by a federal grand jury on January 6, 2010 (the "Superseding Indictment") and a January 17, 2012 district court order describing the trial and evidence (the "January 17 Order").

4 We take official notice of the registration information regarding Bartko in the Central Registration Depository ("CRD"), an electronic database maintained by FINRA and available at https://crd.finra.org. Rule of Practice 323, 17 C.F.R. § 201.323.

for Capstone BD, which was registered as a broker-dealer from 1995 through 2011 and as an investment adviser from 2008 through 2010.

A. Bartko began planning for the Caledonian Fund in January 2004.

Bartko's involvement in the conspiracy that ultimately became the basis for the criminal charges against him began in early 2004. At that time, Bartko began discussions with a business partner, Darryl Laws, about creating Caledonian Partners LLC (Caledonian Fund). Bartko also began speaking with John Colvin about strategies for recruiting investors for the Caledonian Fund through two entities with which Colvin was associated: The Webb Group Financial Services, Inc. and Franklin Asset Exchange, LLC. Colvin explained to Bartko that these two funds operated in tandem; Webb Group performed administrative functions while Franklin Asset Exchange owned and managed Webb Group's investments and capital assets. Colvin also told Bartko about Scott Hollenbeck, Colvin's business partner and salesman for both entities. Hollenbeck was founder and president of Webb Group and founder and co-managing general partner of Franklin Asset Exchange.[5]

On January 19, 2004, Bartko faxed Laws to explain "what John [Colvin and I are] doing to raise this dough." As part of this explanation, Bartko sent Laws promotional documents for Webb Group that promised 12 percent guaranteed investment returns and stated that "investments are secured by [a] surety bond program registered with AIG Insurance Company."[6] In addition, before formalizing this arrangement with Colvin, Bartko gained access to Colvin's and Hollenbeck's disciplinary records with NASD.[7] In order to access these records, Bartko indicated that he was considering Colvin and Hollenbeck for employment. The records showed that Colvin had a history of fraud in the securities industry and that Hollenbeck had been sanctioned for securities sales related misconduct during the previous year and for forgery in 1999.

After Bartko learned this information, he entered into agreements with Colvin committing Webb Group and Franklin Asset Exchange to raising $3 million for the Caledonian Fund. Hollenbeck began promoting the Caledonian Fund during financial seminars he

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5 We take official notice pursuant to Rule of Practice 323 that Colvin was separately convicted of mail fraud, aiding and abetting, and conspiracy relating to his association with Hollenbeck and their fraudulent promotion of investments through Franklin Asset Exchange, Webb Financial Services, and other entities. Colvin was sentenced to a prison term of 25 years and ordered to pay approximately $5.2 million in restitution. *USA v. Colvin*, 4:09cr72 (E.D.N.C. June 11, 2010 & Jan. 18, 2011).

6 Superseding Indictment at 7; January 17 Order at 6–7.

7 FINRA was formed on July 26, 2007, as a result of the merger of the member firm regulatory functions of NASD and NYSE Regulation, Inc. Securities Exchange Act Rel. No. 56148 (July 26, 2007), 72 Fed. Reg. 42146.

conducted at rural Baptist churches throughout the country. Hollenbeck and Franklin Asset Exchange sent Bartko three wire transfers totaling $501,000 in February and March 2004 for the Caledonian Fund. But because Bartko and Laws had not yet formally created the Caledonian Fund or opened a bank account for it, these transfers were wired into a Capstone BD account. They officially formed the Caledonian Fund as an Isle of Man limited liability company and opened a bank account for the fund in April.

By the end of April, Bartko was responding to questions from securities regulators about his own and Hollenbeck's activities. Late that month, NASD audited Capstone BD. During the audit, NASD asked Bartko about the wire transfers to the Capstone BD account. In faxes to Colvin and Laws, Bartko later described the NASD questions as a "snafu" and complained about having "to openly disclose the [Caledonian Fund] investment" to NASD in order "to explain why we had $500,000 come [through] our bank account."[8] To avoid further questions from NASD, Bartko transferred the balance of the money sent by Hollenbeck and Franklin Asset Exchange from the Capstone BD account into his lawyer trust account and asked Colvin to wire future funds for the Caledonian Fund into this trust account.[9] Franklin Asset Exchange accordingly wired an additional $200,000 into Bartko's lawyer trust account in May 2004. The $701,000 in deposits were the only funds raised for the Caledonian Fund. None of this money was actually invested. By November 2004, nearly all of it was depleted and Bartko had received and spent $331,042 from these funds.[10]

On April 26, 2004, the North Carolina Secretary of State Securities Division issued a temporary cease-and-desist order against Hollenbeck based on its investigation of Mobile Billboards of America, Inc., another investment Hollenbeck had promoted by promising a high fixed rate of return. The order charged Hollenbeck, who raised over $10 million for Mobile Billboards, with unregistered securities sales, securities fraud, and sales as an unregistered representative. By May 6, Bartko had agreed to serve as co-counsel representing Hollenbeck in the North Carolina investigation and any other matters arising from that investigation. In connection with this ongoing Mobile Billboards investigation, Bartko received documents from Hollenbeck showing that Hollenbeck was promoting Franklin Asset Exchange by promising guaranteed returns and insured principal.

On September 3, 2004, Bartko met with Hollenbeck and others to discuss whether Hollenbeck should continue selling the Caledonian Fund. During this meeting, Hollenbeck claimed that he had raised approximately 90% of the funds raised through Franklin Asset Exchange in 2003 and 2004, described how he told investors that their principal would be

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8 January 17 Order at 14.

9 Bartko and Laws had already each withdrawn $50,000 from the $501,000.

10 The record does not document all of the withdrawals of the principal, but it indicates that portions were withdrawn by Laws or used for Caledonian Fund expenses that, as noted, did not yield any returns for the investors.

insured and returns were guaranteed, and claimed that he was acting as a "finder" to circumvent broker-dealer registration requirements.

On September 21, 2004, the Commission filed a civil complaint against Mobile Billboards and other entities, charging that they were involved in a Ponzi scheme; these defendants simultaneously consented to orders that, among other things, permanently enjoined future violations, froze assets, and appointed a receiver.[11] In connection with the Commission's ongoing Mobile Billboards investigation, Bartko represented Hollenbeck at a deposition by Commission staff where Hollenbeck admitted to fraudulently using a surety bond to sell Mobile Billboards securities and said that he was then leading church seminars on "biblical principles of money management."[12]

Hollenbeck consented to a final North Carolina Securities Division cease-and-desist order on October 19, 2004. The order found that, among other things, he was not registered as a "salesman or dealer" and that he offered and sold Mobile Billboards securities while omitting material facts necessary to make his statements to investors, in light of the circumstances, not misleading.[13] The order also found that he had been discharged from a registered broker-dealer in May 2002 after it reviewed his Mobile Billboards sales and concluded that they were unauthorized. The order directed Hollenbeck and "any and all persons in active concert and participation with" him to cease and desist from any unregistered securities sales, any securities sales as an unregistered dealer or salesman, and any fraudulent securities sales.[14]

The day after Hollenbeck signed the final cease-and-desist order, Bartko e-mailed Laws that the Commission was investigating Hollenbeck's sales for Mobile Billboards and that, given his legal problems, Hollenbeck had asked if he should turn to Bartko and the Caledonian Fund "as the alternative deployment vehicle for [Hollenbeck's] funds."[15] Bartko sent Laws a second e-mail that day about "[g]et[ting] [Hollenbeck] to commit to raise at least $1.0 million each month for us religiously (no pun intended)."[16] Laws replied, "I would prefer to see one or two

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11 *SEC v. Mobile Billboards of Am., Inc.*, 1:04-cv-02763 (N.D. Ga. filed Sept. 21, 2004); *see also SEC v. Mobile Billboards of Am.*, Litigation Rel. No. 18893, 2004 SEC LEXIS 2159 (Sept. 23, 2004).

12 January 17 Order at 33.

13 *Id.* at 24.

14 *Id.* at 25–26.

15 *Id.* at 26. It is not clear from the record when the Division's Mobile Billboards investigation began focusing on Hollenbeck, but the e-mail indicates that Bartko was aware by October 2004 that the investigation could have implications for Hollenbeck. Nevertheless, Bartko assured Laws that "Scott is not in hot water, but let's just say his clients [aren't] too happy that [Mobile Billboards] is no longer making quarterly distributions." *Id.*

16 Superseding Indictment at 8; January 17 Order at 26.

months where a significant amount was raised, say $3 million, then allow him to modulate down."[17]

On November 1, 2004, Bartko and his co-counsel filed a lawsuit against individuals and entities associated with Mobile Billboards for unregistered securities sales and fraud. Although Hollenbeck was the top salesman for Mobile Billboards, Bartko's lawsuit listed Hollenbeck as a plaintiff rather than a defendant in this suit.[18]

B. Bartko enlisted Hollenbeck to raise investments for Capstone Equity.

In the meantime, Bartko and Laws decided to enlist Hollenbeck's help for a second fundraising effort, this time through another fund, the Capstone Private Equity Bridge & Mezzanine Fund, LLC (Capstone Equity). By this point, "Bartko had sent and received countless . . . documents evincing Hollenbeck's fraud in connection with Webb Group, Franklin Asset Exchange, and fundraising for the Caledonian Fund."[19] But on November 16, 2004, Bartko sent Hollenbeck an offering document for Capstone Equity and, recognizing the need to satisfy accredited-investor requirements for investments into the fund, told Hollenbeck that he wanted to speak with him that day about "how to structure the investments to be made by the non-accredited investors" in the new fund.[20]

Bartko officially formed Capstone Equity on November 23, 2004 as a Delaware LLC, and from early December 2004 to early January 2005, the conspirators raised $1,156,125. Of this amount, $447,000 was an investment from an unsophisticated investor whom Hollenbeck met during an investment presentation at her Baptist church in rural Oregon (the "Oregon Investor"). During his presentation, Hollenbeck said that "the investment was insured for up to $1.0 million."[21] After a separate meeting with her pastor and Hollenbeck to discuss the investment, the Oregon Investor made her investment by writing two checks to Capstone Equity.

Although Bartko did not attend this meeting, he reviewed the Oregon Investor's suitability questionnaire showing that she and her husband did not meet the income or net worth thresholds for accredited investors. Bartko nevertheless deposited the Oregon Investor's checks

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17 Superseding Indictment at 8.

18 The record does not make clear the theory for Hollenbeck's relief from the defendants.

19 January 17 Order at 29.

20 *Id.* at 30. An "accredited investor" includes "[a]ny natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000" or with "individual income in excess of $200,000 in each of the two most recent years or joint income . . . in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year . . . " 17 C.F.R. § 230.501(a)(5)–(6).

21 January 17 Order at 35.

and retained the funds. Bartko also corresponded with the Oregon Investor on behalf of the fund, sending the investor quarterly statements dated December 22, 2004 and March 31, 2005. Two days before Bartko sent the first of these statements, the Division notified Bartko that it intended to recommend proceedings against Hollenbeck in connection with his Mobile Billboards sales.[22]

Around January 2005, Bartko sought help from two persons who had been involved in marketing Mobile Billboards, Webb Group, and Franklin Asset Exchange and who, like Hollenbeck, were subject to cease-and-desist orders from the North Carolina Securities Division in connection with its Mobile Billboards investigation. He asked these two persons to run a purported investment club as a vehicle for investments in Capstone Equity by individual non-accredited investors. Meanwhile, in January 2005, Bartko sent refund checks to some of the individual investors in Capstone Equity with letters explaining that they did not qualify as accredited investors under the Securities Act. Hollenbeck, with Bartko's knowledge, then encouraged the investors who received refunds to re-invest their funds into Capstone Equity through the investment club. Ten investors agreed; among those persuaded to reinvest were a seventy-four-year-old retired postal worker who had invested the proceeds of the sale of a family farm to care for her mother;[23] an unemployed widow who invested from the remaining proceeds from a life insurance policy; and a seventy-year-old retired furniture factory worker. For redirecting these funds into the scheme, the investment club received a 6% fee, which its representatives split with Hollenbeck. The Capstone Fund ultimately generated more than $2.6 million in investments from forty investors.

In February 2005, the North Carolina Securities Division alerted our Enforcement Division to evidence of Hollenbeck's fraudulent sales for Capstone Equity and during a meeting in March, Enforcement Division staff asked Bartko about Hollenbeck's connection to Capstone Equity. In September 2005, the Capstone Equity funds were returned to investors, less the investment club's fee.

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22 On May 13, 2005, the Commission filed a civil complaint against Hollenbeck and other Mobile Billboards salesmen in the United States District Court of the Northern District of Georgia, alleging that Hollenbeck knew or recklessly ignored information showing that Mobile Billboards was a Ponzi scheme, made sales to "older and retired investors" as a "safe, secure investment" and forged a surety bond falsely stating that the individual investors' investments were insured. On July 23, 2008, he was permanently enjoined from future violations of Sections 5 and 17(a) of the Securities Act, Sections 10(b) and 15(a) of the Exchange Act, and Exchange Act Rule 10b-5. He was ordered to pay $3.4 million in disgorgement, representing profits resulting from the conduct alleged in the complaint, and prejudgment interest. *SEC v. Hollenbeck*, 1:05cv1272 (N.D. Ga. May 13, 2005 & July 23, 2008)

23 Bartko was convicted for the offer and sale of unregistered securities to this investor in January 2005 and for mail fraud in correspondence with this investor between January 19, 2005 and April 18, 2005. Superseding Indictment at 11–12.

C. Bartko was indicted and convicted in 2010.

On January 6, 2010, a federal grand jury returned a Superseding Indictment charging Bartko with one count of conspiracy to commit mail fraud, money laundering, and unregistered securities sales (18 U.S.C. § 371), four counts of mail fraud (18 U.S.C. §§ 1341 and 1342), and one count of selling unregistered securities (15 U.S.C. §§ 77e, 77x and 18 U.S.C. § 2).[24] The indictment charged that Bartko led a criminal scheme to generate purported investments from members of rural Baptist churches and others. It alleged that, between January 2004 and April 2005, he knowingly conspired to conceal the true source and nature of the funds and the fraud by which they had been obtained, and to convert the funds to the personal use of Bartko and the other conspirators. The indictment also alleged that Bartko formed Caledonian Fund and Capstone Equity to create a false impression of legitimacy to further the scheme.

After a thirteen-day trial, a jury found Bartko guilty of one count of conspiracy, four counts of mail fraud, and one count of selling unregistered securities.[25] On November 18, 2010, the district court entered judgment against Bartko. Bartko moved for a new trial, claiming that the government failed to disclose evidence as required under *Brady v. Maryland*, 373 U.S. 83 (1963), and knowingly permitted government witnesses to give false testimony in violation of *Giglio v. United States*, 405 U.S. 150 (1972). The court denied Bartko's motions for a new trial in the January 17 Order. The January 17 Order summarized the evidence, concluded that the trial comported with due process, and found that the jury verdict "is worthy of confidence" because the "case was not a close one. The trial record reveals overwhelming evidence of Bartko's guilt."[26] On April 4, 2012, Bartko was sentenced to 23 years of imprisonment and three years of supervised release, and was ordered to pay joint and several restitution of $885,946.89 to about 200 investors. Bartko appealed to the United States Court of Appeals for the Fourth Circuit.

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24 The Superseding Indictment originally charged that Bartko also made false statements to FBI agents on January 2009 and October 2009 and that he conspired to make false statements to an executive agency and obstruct SEC proceedings. On October 29, 2010, on the government's motion, the court dismissed these charges from the indictment.

25 The jury verdict did not specify the objects of the conspiracy.

26 January 17 Order at 2 & 118.

III.

A. The Commission instituted administrative proceedings in 2012.

On January 18, 2012, we initiated an administrative follow-on proceeding against Bartko pursuant to Exchange Act Section 15(b) and Advisors Act Section 203(f) to determine whether he had been convicted and whether any administrative response is in the public interest.[27]

During a pre-hearing conference on March 8, 2012, the law judge addressed the Division's obligation under Rule of Practice 230 to make available to Bartko the documents it obtained "in connection with the investigation leading to [its] recommendation to institute proceedings."[28] The Division stated that it did not have documents to produce to Bartko under the rule because the follow-on proceeding was based on public filings from the criminal case. Bartko then said "[i]f there's no investigative file, I sort of understand that . . . that doesn't surprise me" and that he had access to the public criminal record.[29] Bartko subsequently filed a motion seeking a subpoena under Rule of Practice 232 to compel the Commission staff to produce all documents relating to, among other things, Capstone Equity, Caledonian Fund, and other communications related to the investigation giving rise to the criminal charges. The law judge denied Bartko's subpoena request on March 30, 2012, finding it "unreasonable and excessive in scope" and noting that "[i]t does not appear that the requested documents would provide Respondent with any information, not already in his possession, that would be relevant to the public interest factors."[30]

On August 21, 2012, the administrative law judge granted a motion for summary disposition by the Division. The law judge found that the first two conditions for jurisdiction under both Advisers Act Section 203 and Exchange Act Section 15(b) had been satisfied—that Bartko's criminal offenses were covered under each statute and he was associated with both a broker-dealer and a registered investment adviser during the relevant period. But finding that Bartko's jury verdict was entered on November 18, 2010 and he was not sentenced until April

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27 On January 18, 2012, we also issued an order suspending Bartko from appearing or practicing before the Commission pursuant to Rule of Practice 102(e)(2) based on his November 18, 2010 felony conviction. *See Gregory Bartko, Esq.*, Exchange Act Rel. No. 66182, 2012 SEC LEXIS 170 (Jan. 18, 2012).

28 17 C.F.R. § 201.230.

29 Pre-Hearing Conf. Tr. at 7 & 8.

30 *Gregory Bartko*, Admin. Proc. Rulings Rel. No. 700, 2012 SEC LEXIS 1038, at *2 & 3 (Mar. 30, 2012). On April 20, 2012, Bartko also filed a motion for a stay pending his criminal appeal. Although Bartko asserts in his brief that the motion was not addressed, the record confirms that the law judge denied it on April 23, 2012.

2012, the law judge found that the jury verdict was a conviction as defined in the Advisers Act but suggested—without deciding—that it would not be a conviction under the Exchange Act.[31]

The law judge then rejected Bartko's claims that his conviction was the result of prosecutorial misconduct and that such misconduct should be considered as a mitigating factor in the follow-on proceeding. The law judge barred Bartko from association with any investment adviser, broker, dealer, municipal securities dealer, or transfer agent but declined to bar Bartko from associating with a municipal advisor or NRSRO. This appeal followed.[32]

B. The court of appeals affirmed Bartko's conviction in 2013.

On August 28, 2013, while this appeal was pending, the United States Court of Appeals for the Fourth Circuit affirmed Bartko's conviction and deemed the January 17 Order "comprehensive and well-reasoned."[33] The Fourth Circuit conducted its own "exhaustive review of the record" in light of Bartko's procedural claims and approvingly quoted the district court's conclusions that "Bartko's case was not a close one [because the] trial record reveals overwhelming evidence of Bartko's guilt" and "[t]he mountain of evidence marshaled against Bartko demonstrated his guilt beyond any shadow of a doubt."[34] Although it found that certain evidence was not timely disclosed to the defense, it ultimately concluded that there was "no reasonable probability" that earlier disclosure of this evidence "could have produced a different result" at the trial.[35] The court stated that its "confidence in the jury's conviction of Bartko was not undermined by the government's misconduct in this case," but expressed serious concerns about the frequency of similar discovery errors in the district and urged improvements to discovery procedures to prevent future errors.[36]

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31 Citing Advisers Act Section 202(a)(6), 15 U.S.C. § 80b-2(a) (defining "convicted" to "include a verdict, judgment, or plea of guilty . . . whether or not sentence has been imposed"). The law judge equated the terms "conviction" and "sentencing" but did not cite any authority or analysis indicating that a conviction under the Exchange Act is contingent on sentencing.

32 In granting Bartko's petition for review, we advised the parties of our decision to review what sanctions, if any, were appropriate. Order Granting Pet. For Review and Scheduling Briefs, Sept. 20, 2012, at 1. *See* 17 C.F.R. § 201.411(d).

33 Pursuant to Rule of Practice 323, 17 C.F.R. § 201.323, we take official notice of the Fourth Circuit opinion. *United States v. Bartko*, No. 12-4298, 2013 U.S. App. LEXIS 17914, at *9 (4th Cir. Aug. 23, 2013).

34 *Id.* at *28.

35 2013 U.S. App. LEXIS 17914, at *28.

36 *Id.* at *32.

IV.

As relevant here, Exchange Act Section 15(b) and Advisers Act Section 203 each authorizes administrative proceedings against any person who (i) has been convicted of certain enumerated offenses, including any felony or misdemeanor involving the purchase or sale of any security, any conspiracy to commit such an offense, or mail fraud; (ii) within ten years of the commencement of the proceedings; (iii) if such person was associated "at the time of the alleged misconduct," with a broker or dealer or investment adviser, as the case may be.[37] On January 10, 2013, we sought additional briefing from the parties to clarify the legal and factual basis for proceeding under each statute.[38]

The parties' additional briefing clarifies that, although Bartko challenges the Commission's jurisdiction under both statutes, the parties do not dispute the following facts: The misconduct giving rise to Bartko's convictions took place from 2004 to April 2005 (the "relevant period"). During the relevant period, Bartko was associated with Capstone BD and Capstone BD was registered with the Commission as a broker-dealer but, contrary to the charge in the OIP, it was not registered as an investment adviser. On November 10, 2010, a jury found Bartko guilty of conspiracy, mail fraud, and unregistered securities sales, and the court entered these verdicts.

We find that Advisers Act Section 203(f) is not an appropriate basis for remedies in this case. The public record does not indicate that Bartko was associated with a registered investment adviser during the relevant period as charged in the OIP. As the Division conceded in its response to the additional briefing order, there is not sufficient evidence in the record to conclude that Bartko was then associated with an investment adviser.[39]

We further find, based on our independent review of the undisputed facts, that the requirements for discipline under Exchange Act Section 15(b) have been satisfied. Each jury

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[37] 15 U.S.C. § 78*o*(b)(6)(A)(ii), (b)(4)(B); 15 U.S.C. § 80b-3(e)(4), (f). The phrase "at the time of the alleged misconduct" means the time of the wrongful activity, not the time of the conviction. *Kornman v. SEC*, 592 F.3d 173, 183–84 (D.C. Cir. 2010).

[38] Rule 411(d) authorizes us "at any time prior to issuance of [our] decision, [to] raise and determine any other matters that [we] deem[] material, with opportunity for oral or written argument thereon by the parties." 17 C.F.R. § 201.411(d).

[39] We do not reach the question of whether Bartko was an unregistered investment adviser or was associated with an unregistered investment adviser during the relevant period because the OIP did not allege this as a statutory basis and the parties have not directly addressed it. *Cf. Gary M. Kornman*, Exchange Act Rel. No. 59403, 2009 SEC LEXIS 367, at *13 (Feb. 13, 2009), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010) (finding Advisers Act applied to person associated with an unregistered investment adviser); *see also* Resp't Br. at 4 (stating that "Capstone Partners, L.C.'s business model was limited to investment advisory services, private placement agent services and related investment banking functions").

verdict entered in the criminal case is an independent basis for remedies under Section 15(b), and Bartko was associated with a broker-dealer during the relevant period. Moreover, although the law judge found it unnecessary to reach the issue, Bartko was convicted within the meaning of the Exchange Act when the verdict was returned on November 18, 2010, and the OIP was issued within ten years of this conviction.

Bartko asserts that the term "conviction" in the Exchange Act is ambiguous and that we should defer to rules of criminal procedure and non-securities statutes to adopt the position alluded to by the law judge that Bartko was not convicted for purposes of the Exchange Act until he was sentenced. To the contrary, we have long held that a person has been convicted for purposes of an Exchange Act follow-on proceeding when a jury reaches a guilty verdict that is entered by the court.[40] Furthermore, we agree with the Division that "there i[s] no reason for ascribing a different meaning to the word 'convicted' in the Exchange Act to the meaning given to that term in the Advisers Act."[41] In fact, Bartko previously conceded that "for every stage of this proceeding, in every filing made by Bartko in opposition to the OIP, [he] admitted the fact that he was . . . convicted on November 18, 2010."[42] Bartko asserts, without any convincing explanation, that he should be deemed convicted on different dates under the Exchange Act and the Advisers Act—although both statutes provide for the same type of administrative proceeding and the same type of remedial inquiry into the convicted person's fitness to associate in the securities industry.

Bartko further argues that Exchange Act Section 15(b) does not apply because Capstone BD "had no factual connection to the events described at Bartko's criminal trial."[43] But each of Bartko's convictions is independently encompassed by Exchange Act Section 15, which covers

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40 *Alexander Smith*, Exchange Act Release No. 37885, 22 SEC 13, 1946 SEC LEXIS 228, at *18 (Feb. 5, 1946) (stating that "it is clear that when there has been a verdict or plea of guilt or a plea of nolo contendere accepted by the Court, there is the 'conviction' contemplated by [Exchange Act Section 15(b)] as the starting point for an inquiry into the fitness of the person involved to engage in the securities business"); *Eric S. Butler*, Exchange Act Rel. No. 65204, 2011 SEC LEXIS 3002, at *12 n.17 (Aug. 26, 2011) (finding that a jury verdict is a conviction under the Exchange Act); *see also Delegation of Authority to the Secretary of the Comm'n*, Exchange Act Rel. No. 45848, 67 Fed. Reg. 30326, 30326 n.5 (May 6, 2002) (indicating that, in follow-on proceedings under both the Exchange Act and the Advisers Act, "a criminal conviction 'includes a verdict, judgment, or plea of guilty, or a finding of guilt on a plea of nolo contendere, if such verdict, judgment, plea, or finding has not been reversed, set aside, or withdrawn, whether or not sentence has been imposed'").

41 Division Supp. Br. at 8. *Cf. Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003) (holding that the scienter standard under Exchange Act Section 10(b) also applies to Advisers Act Section 206(1) because the operative language "is nearly identical").

42 Resp't Br. at 3.

43 *Id.* at 6.

convictions involving the purchase or sale of securities, conspiracy to commit an offense involving securities purchases or sales, and mail fraud.[44] The securities laws authorize follow-on proceedings based on a variety of "crimes that suggest a lack of fitness" for the industry;[45] the predicate misconduct is not limited to one's actions as a broker-dealer.[46]

Bartko also argues that Exchange Act Section 15(b) may not be applied as "an independent jurisdictional basis for an associational bar" and that there was "no subject matter jurisdiction to support the OIP."[47] He claims that any objection to the law judge's interpretation of the Exchange Act has been waived and that this "jurisdictional defect[]" cannot be cured on appeal.[48] Bartko is mistaken. The OIP cited Exchange Act Section 15(b) as a basis for this proceeding. Although the law judge elected not to decide whether Section 15(b) authorized this proceeding, this does not negate the basis for Commission jurisdiction under the statute. And in ordering additional briefing as part of our independent review, we exercised our authority to consider this issue under Rule of Practice 411(d), which authorizes us "at any time prior to the issuance of [our] decision, [to] raise and determine any other matters that [we] deem[] material, with opportunities for oral or written argument thereon by the parties."[49] The OIP and additional briefing order placed Bartko on notice that Exchange Act Section 15(b) was a potential basis for administrative remedies and the briefing order gave him an opportunity to address the issue on appeal.[50] Bartko has taken this opportunity to challenge the application of Exchange Act Section 15(b) on a number of grounds, which we have addressed.

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44 15 U.S.C. §§ 78o(b)(6), 78o(b)(4)(B)(i), (iv).

45 *Kornman*, 592 F.3d at 184.

46 *See* 15 U.S.C. § 78o(b)(4)(B)(i), (iii) (covering, for example, convictions for false oaths, bribery, perjury, burglary, larceny, theft, robbery, forgery, extortion, and counterfeiting). In any case, the record contradicts Bartko's claim that his conduct was unrelated to his broker-dealer. Bartko arranged for $500,000 in investor funds from the investment scheme to be sent into a bank account for Capstone BD.

47 Reply at 10.

48 Resp't Supp. Br. at 6.

49 17 C.F.R. § 201.411(d).

50 *Aloha Airlines, Inc. v. Civil Aeronautics Board*, 598 F.2d 250, 262 (D.C. Cir. 1979) (notice is "sufficient if the respondent 'understood the issue' and 'was afforded full opportunity' to justify its conduct during the course of the litigation'"); *Wendy McNeeley, CPA*, Exchange Act Release No 68431, 2012 SEC LEXIS 3880, at *28 (Dec. 13, 2012) (finding notice sufficient when the relevant allegation was covered in the OIP); *Ira Weiss*, Exchange Act Rel. No. 52875, 2005 SEC LEXIS 3107, at *50–51 (Dec. 2, 2005) (finding that the OIP placed respondent on notice of the charges against him even though it did not specify the subsection of the Securities Act under which he was found liable).

Bartko also contends that this proceeding is time barred under the five-year statute of limitations in 28 U.S.C. § 2462. We find this claim without merit, both because § 2462's five-year limitations period does not apply to this proceeding and because, in any event, this proceeding was instituted on January 18, 2012, which was only 14 months after Bartko's November 18, 2010 conviction—the event triggering this cause of action under Exchange Act Section 15(b)(6).

Section 2462 does not apply to this proceeding for two independent reasons. First, § 2462 expressly provides that it does not apply when the period for commencing proceedings has been "otherwise provided by Act of Congress" in the operative statute.[51] Exchange Act Section 15(b)(6) expressly authorizes the Commission to commence a proceeding up to ten years from the date of a covered conviction.[52] Second, the five-year statute of limitations does not apply because this proceeding is not "for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise" within the meaning of § 2462. Bartko argues that the associational bars at issue in this proceeding are punitive sanctions covered by § 2462.[53] But as we held in *Lawton*, the remedies analysis is not driven by the need to punish respondents; rather the analysis is prospective and focuses on Bartko's "current competence" and the "degree of risk" he poses to public investors and the securities markets in each of the areas covered by the remedies.[54]

Bartko has filed a motion for leave to file supplemental authority, arguing that the Supreme Court's decision in *Gabelli v. SEC* supports his statute of limitations claim.[55] *Gabelli* held that the § 2462 limitations period begins when the underlying cause of action comes into effect and that the common law fraud "discovery rule" does not apply in Commission

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51 *William F. Lincoln*, Exchange Act Rel. No. 39629, 1998 SEC LEXIS 193, at *10 (Feb. 12, 1998).

52 15 U.S.C. § 78o(b)(6)(A)(ii); *see Johnson v. SEC*, 87 F.3d 484, 492 & n.15 (D.C. Cir. 1996) (stating that the "as otherwise provided by Act of Congress" exception applies to Exchange Act Section 15 follow-on proceedings against a broker "who has been convicted by a foreign court of a securities violation within the past ten years").

53 Mem. of Supp. Authority at 6.

54 *Lawton*, 2012 SEC LEXIS 3855, at 28 n.34, citing *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996); *see also id*, at *26 & nn. 32–33 *et seq.* (stating that Commission bars are not based on a need to "to punish the respondent for past misconduct or to remedy past harms suffered by victims of that misconduct" but rather "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"); *SEC v. Quinlan*, 373 F. App'x 581, 588 (6th Cir. 2010) (finding that an officer and director bar was not punitive for purposes of the § 2462 limitations period when "the district court concluded that there was a risk of recurrence [and] that the risk to the investing public outweighed the severe collateral consequences of the equitable relief").

55 133 S. Ct. 1216 (2013).

enforcement actions.[56] As a discretionary matter, we grant his motion but conclude that *Gabelli* is not on point.

Bartko correctly concedes that *Gabelli* is not "controlling precedent in this proceeding . . . ."[57] *Gabelli* did not address whether § 2462 or another statutory timeframe applied to the underlying cause of action or whether the remedy was a penalty covered by § 2462—the two independent bases for our conclusion that § 2462 does not apply here. Instead, *Gabelli* addressed the applicability of the "discovery rule" in an action with a claim for civil penalties that was indisputably subject to § 2462's five-year limitations period. Moreover, *Gabelli* confirmed that even if the five-year statute of limitations applied, it would be satisfied here, explaining that a claim accrues within the meaning of § 2462 "when the plaintiff has a complete and present cause of action" and when the underlying claim "comes into existence."[58] Exchange Act Section 15(b)(6) was not triggered, and the cause of action was not complete, until Bartko was convicted.[59] And contrary to Bartko's attempt to circumvent the language of the Exchange Act, nothing in what Bartko describes as *Gabelli*'s discussion of "policy considerations" or the "remedial versus punitive dichotomy" indicates that the underlying statute should be disregarded to determine when the claim accrues. Bartko argues that *Gabelli* stands for the proposition that respondents "should not be exposed to government enforcement action . . . for an additional uncertain period of time into the future," but the ten-year post-

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56 We have considered *Gabelli* as part of our independent review, but decline to consider new arguments Bartko raised in his Memorandum of Supplemental Authority and Reply to the Division of Enforcement's Brief in Opposition to Respondent's Motion for Leave to File Supplemental Authority (focusing for instance, on *Rotella v. Wood*, 528 U.S. 549 (2000), the statute of limitations for a cause of action under the Racketeer Influenced and Corrupt Practices Act, and the statute of limitations for different provisions of the securities laws and monetary penalties). *See* Rule of Practice 450, 15 U.S.C. § 201.450 ("No briefs in addition to those specified in the briefing schedule order may be filed except with leave of the Commission").

57 Rep. to Division Br. Opp. Resp't Mot. for Leave to File Supp. Authority at 3.

58 133 S. Ct. at 1220.

59 *See Michael T. Studer*, Exchange Act Rel. No. 50411, 2004 SEC LEXIS 2135, at *10 (Sept. 20, 2004) (stating that the "five-year limit specified in 28 U.S.C. § 2462 does not apply" and that a follow-on cause of action "did not 'accrue' within the meaning of that statute until the injunction . . . was entered"); *Lincoln*, 1998 SEC LEXIS 193, at *11 (stating "for the purposes of [§] 2462, it is the date of . . . conviction, not the conduct underlying the conviction, which is relevant"); *see also Proffitt v. FDIC*, 200 F.3d 855, 864–65 (D.C. Cir. 2000) ("While the FDIC might well have brought an action earlier under [another statutory provision], its failure to do so does not render untimely, and therefore, unauthorized, its action based on the later occurring effect.").

conviction period for instituting follow-on proceedings under the Exchange Act is fixed and does not create the type of uncertainty addressed by the Court in *Gabelli*.[60]

V.

A. Bartko's conduct demonstrates unfitness for the securities industry.

We next turn to assessing what remedies are in the public interest. In so doing, 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.[61] Our "inquiry into . . . the public interest is a flexible one, and no one factor is dispositive."[62]

1. The record evidence demonstrates the propriety of a broker-dealer bar.

The record demonstrates the egregiousness of Bartko's misconduct, which was neither brief nor isolated. He violated the most basic investor protection principles in the securities laws, orchestrating a conspiracy that defrauded approximately two hundred investors out of hundreds of thousands of dollars over more than a year. This conspiracy relied on repeated false promises of insured and guaranteed investment returns and victimized financially unsophisticated investors.[63]

Bartko acted with a high degree of scienter. With fraudulent intent, he led the scheme to induce investments based on false claims about their legitimacy, safety, and investment returns. After learning about Colvin and Hollenbeck's disciplinary histories and fraudulent sales techniques, Bartko chose to rely on them as the primary source for soliciting investors. Even after learning about the scrutiny that Hollenbeck's sales were drawing from securities regulators,

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60 Mem. of Supp. Authority at 6.

61 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

62 *David Henry Disraeli*, Exchange Act Rel. No. 57027, 2007 SEC LEXIS 3015, at *61 (Dec. 21, 2007), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008).

63 *See Epstein v. SEC*, 416 F. App'x 142, 146 (3d Cir. 2010) (affirming bar where the Commission had determined that violations were egregious because they were perpetrated against elderly and unsophisticated clients); *see also Butcher & Singer Inc.*, Exchange Act Rel. No. 23990, 48 SEC 640, 1987 SEC LEXIS 2813, at *21 (Jan. 13, 1987) (describing "fraudulent representations to an unsophisticated customer" as egregious), *aff'd*, 833 F.2d 303 (3d Cir. 1987) (without opinion).

Bartko chose to continue to rely on Hollenbeck's fundraising and even consulted him while structuring investments in Capstone Equity.

The remaining public interest factors confirm the public interest in a bar. Bartko has demonstrated unwillingness to accept any responsibility—or show remorse—for his actions. In the criminal proceedings, he attempted to shift responsibility for his own conduct to Hollenbeck, despite the overwhelming evidence that Bartko knowingly and repeatedly chose to rely on Hollenbeck's fraudulent sales tactics. It is also particularly noteworthy that on appeal Bartko again seeks to shift the focus of the proceeding away from his own violative conduct, this time to the government's investigation and other procedural claims. Contrary to Bartko's assertion that his unwillingness to accept responsibility should not be considered because "he committed no violations to begin with nor was his conduct unlawful," this factor has long been deemed an appropriate measure of fitness for association in the industry.[64] In light of Bartko's conviction for conspiracy, mail fraud, and selling unregistered securities, we find that his assessment of his role in defrauding approximately two hundred investors over more than a year further demonstrates a fundamental lack of commitment to investor protection principles required to "insure honest securities markets and thereby promote investor confidence"[65] throughout the industry and the risk that he would engage in similar conduct if presented with future opportunities.[66]

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64 *See, e.g.*, *Seghers v. SEC*, 548 F.3d 129, 137 (D.C. Cir. 2008) (consideration of this factor "did not unconstitutionally burden [respondent] in the district court. . . nor did it deny him due process before the SEC").

65 *United States v. O'Hagan*, 521 U.S. 642, 658 (1997).

66 *See Scott B. Gann*, Exchange Act Rel. No. 59729, 2009 SEC LEXIS 1163, at *19 (Apr. 8, 2009) (noting that a refusal to recognize wrongful conduct reveals "a fundamental misunderstanding of the duties of a securities industry professional that presents a significant likelihood that he will commit similar violations in the future"); *see also Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004) (noting that "the existence of a violation raises an inference that it will be repeated").

2. The January 17 Order is relevant to the analysis of the public interest.

Bartko argues that the January 17 Order should not be considered in conducting the public interest analysis, claiming that the January 17 Order may not be considered without re-assessing the entire criminal record and satisfying each of the requirements for collateral estoppel. Bartko concedes that "in theory issue preclusion or collateral estoppel are doctrines that apply in administrative proceedings following a criminal conviction" but contends that preclusion was unfairly applied in this case, emphasizing that the criminal conviction was based on a general jury verdict and that the January 17 Order addressed issues that arose in "post-conviction proceedings."

Bartko downplays his state of mind when he engaged in the conduct for which he was convicted, but he is collaterally estopped from disputing that he acted with the requisite scienter to establish his fraud convictions. Estoppel is properly applied to a criminal verdict, whether general or specific, regarding the issues decided in the criminal case.[67] Bartko was convicted, among other things, for "devis[ing] a scheme and artifice to defraud" investors, and "knowingly" causing delivery of documents in connection with this scheme.[68]

Moreover, follow-on proceedings have long considered district court findings, including in cases following a general verdict, as evidence of the public interest that is not open to collateral challenge.[69] Courts have repeatedly approved this practice.[70] Here, Bartko offers no

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67 *See Ashe v. Swenson v. United States*, 397 U.S. 436, 443–45 (1970) (applying collateral estoppel to general verdict when the contested issues were determined by the verdict).

68 Indictment at 11.

69 *See, e.g.*, *Butler*, 2011 SEC LEXIS 3002, at *21 (noting that "we have long held that follow-on proceedings based on a criminal conviction are not an appropriate forum to 'revisit the factual basis for,' or legal defenses to, [a] conviction"); *Phillip J. Milligan*, Exchange Act Rel. No. 61790, 2010 SEC LEXIS 1163, at *13 (Mar. 26, 2010) (noting that "findings made by the court in the underlying proceeding" are properly considered "in determining the appropriate [follow-on] sanction"); *Charles Phillip Elliott*, Exchange Act Rel. No. 31202, 50 SEC 1273, 1992 SEC LEXIS 2334 (Sept. 17, 1992) (considering, as evidence of the public interest, findings in sentencing memorandum, receiver's report, court order denying post-trial motion, and sentencing transcript, as well as injunctive complaint and criminal indictment); *Michael C. Pattison*, Exchange Act Rel. No. 67900, 2012 SEC LEXIS 2973, at *24–25 (Sept. 20, 2012) (stating, in a proceeding under Rule of Practice 102(e), that a respondent in a follow-on proceeding based on an injunction "is not permitted to collaterally attack the underlying injunction or findings of the court"); *see also* Rule of Practice 320, 17 C.F.R. § 201.320 (permitting the Commission or hearing officer to receive relevant evidence).

70 *Studer v. SEC*, 148 F. App'x 58, 59 (2d Cir. 2005) (finding that respondent, in an appeal of a follow-on administrative proceeding "is prohibited from relitigating the factual and legal conclusions of the district court regarding his violations of federal securities laws"); *see also*

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reason to doubt that the January 17 Order reflects the facts and issues contested during the criminal trial and the basis for his criminal convictions and, as such, is fairly considered as evidence of his fitness to associate in the securities industry.[71] In denying Bartko's motion for a new trial, the January 17 Order reviewed the entire trial record, including factual issues contested during the trial and his claims that the government violated due process by failing to disclose evidence and permitting false testimony during the criminal trial. The January 17 Order concluded that he "received a fair trial in compliance with due process" and that the "jury verdict is worthy of confidence."[72] Based on its review, the court observed that "[u]ltimately, the trial focused on Bartko's knowledge, intent, and good faith" and concluded that the "case was not a close one. The trial record reveals overwhelming evidence of Bartko's guilt" and that there was a "mountain of evidence marshaled against Bartko [that] demonstrated his guilt beyond any shadow of a doubt."[73] These findings were affirmed by the Fourth Circuit in the criminal appeal, which was the appropriate forum for any challenges to these conclusions or the evidence on which they were based.[74]

In a further challenge to the evidence, Bartko argues that the law judge failed to properly apply the "reliable[,] probative and substantial" standard for evidence under the Administrative

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Gann v. SEC, 361 F. App'x 556, 558 n.3 (5th Cir. 2010) (finding, in an appeal of a follow-on administrative proceeding, that "[b]ecause the factual issues in this case were fully litigated and resolved in the district court, we treat the district court's findings of fact as conclusive and binding on the parties"); *Brownson v. SEC*, 66 F. App'x 687, 688 (9th Cir. 2003) (finding, in a follow-on proceeding appeal, that respondent's "plea agreement and criminal conviction are substantial evidence supporting the SEC's conclusion that it is in the public interest to permanently bar [respondent] from association with a broker or dealer").

71 *See Kornman v. SEC*, 592 F.3d 173, 187 (D.C. Cir. 2010) (finding that the Commission, in an appeal of a follow-on administrative proceeding could "reasonably reject, in view of the criminal record, Kornman's attempts to minimize the gravity of his [conduct] and his mental state"); *SEC v. Bilzerian*, 29 F.3d 689, 693 (D.C. Cir. 1994); *Maietta v. Artuz*, 84 F.3d 100, 103 n.1 (2d Cir. 1996); *see also Armstrong v. SEC*, 476 F. App'x 864, 865 (D.C. Cir. 2012); *Elliott v. SEC*, 36 F.3d 86, 87 (11th Cir.1994) (per curiam); *cf. United States v. Bras*, 483 F.3d 103, 107–08 (D.C. Cir. 2007) (finding that judicial factfinding may satisfy a "preponderance of the evidence standard" for sentencing purposes).

72 January 17 Order at 118 & 119.

73 January 17 Order at 1 & 2.

74 *Franklin*, 2007 SEC LEXIS 2420, at *11 (finding, in a proceeding instituted under Exchange Act Section 15(b)(6)(A), that "[t]he appropriate forum for Franklin's challenge to the validity of the injunction and the district court's evidentiary rulings is through an appeal to the United States Court of Appeals, which . . . Franklin is pursuing and in which he is raising some of these same issues"), *petition denied*, 285 F. App'x 761 (D.C. Cir. 2008) (per curiam).

Procedure Act.[75] He contends that this standard is not consistent with the preponderance of the evidence standard of proof that was applied by the law judge pursuant to *Steadman v. SEC*,[76] which Bartko argues applies only to securities fraud. To the contrary, the preponderance standard applies in administrative proceedings addressing a variety of violations,[77] and the preponderance analysis in *Steadman* is based on the Supreme Court's interpretation of the Administrative Procedure Act, not the securities laws.[78] Moreover, while it is unclear whether Bartko's objection is to the nature of the evidence in the record or the weight given to the evidence, he has not substantiated either type of objection. He has not offered any basis for doubting the relevance, reliability, or probative value of the January 17 Order's findings regarding the conduct giving rise to his convictions. Nor has he identified any evidence, either in the record or that he identified and sought to adduce before the law judge, that would undermine those findings or demonstrate that allowing him to participate in the securities industry would be in the public interest.

Bartko argues that it is unfair to rely on the January 17 Order because it does not address his claims of prosecutorial misconduct and collusion. But collateral estoppel is not the basis for the finding, discussed below, that such claims do not raise a genuine issue of mitigation in this proceeding because they are not relevant to the risks posed by Bartko's participation in the securities industry.[79] And as we have long held, follow-on proceedings are not the proper forum for addressing claims of prosecutorial or Division misconduct.[80] Bartko's criminal

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75 5 U.S.C. § 556(d).

76 450 U.S. 91 (1981).

77 *See, e.g., Kornman*, 592 F.3d at 187 (approving Commission bar order in an administrative proceeding following a conviction for providing a false statement after the Commission "consider[ed] the mitigating factors pursuant to an analysis of the *Steadman* factors").

78 450 U.S. 91, 102 (1981) (finding that the APA evidentiary standards were adopted to "eliminat[e] . . . agency decisionmaking premised on evidence which was of poor quality—irrelevant, immaterial, unreliable, and nonprobative—and of insufficient quantity—less than a preponderance").

79 *Cf. Fireman's Fund Ins. Co. v. Stites*, 258 F.3d 1016, 1022 (9th Cir. 2001) (finding that the court relied on "traditional summary judgment principles" rather than collateral estoppel in rejecting a factual challenge); *Kornman v. SEC*, 592 F.3d 173, 188 (D.C. Cir. 2010) (finding no hearing on mitigation necessary when there was no evidence adduced supporting mitigation).

80 *See Frederick W. Wall*, Exchange Act Rel. No. 52467, 2005 SEC LEXIS 2380, at *11 (Sept 19, 2005) (declining to consider claims of "evidence obstruction and witness tampering" in the underlying criminal proceedings); *see also James E. Franklin*, Exchange Act Rel. No. 56649, 2007 SEC LEXIS 2420, at *13 (Oct. 12, 2007) (stating that "this is not the appropriate forum for challenging the propriety of the Division's conduct"), *petition denied*, 285 F. App'x 761 (D.C. Cir. 2008); *Lincoln*, 1998 SEC LEXIS 193, at *7, 8 (finding that collateral estoppel "extends to issues relating to the validity of the conviction" and "the exercise of prosecutorial discretion").

proceedings—including his appeal—afforded him an opportunity to pursue his procedural and other objections to the prosecution,[81] and the court of appeals, like the district court, ultimately concluded that its "confidence in the jury's conviction of Bartko was not undermined . . . ."[82] If Bartko had prevailed in overturning all of the verdicts, he could have filed a motion to vacate the administrative order.[83] Accordingly, we find it appropriate to consider the January 17 Order as evidence of the public interest in barring Bartko from associating with a broker or dealer.

B. Collateral bars are not impermissibly retroactive.

As we explained in *John W. Lawton*, bars from associating with any investment adviser, municipal securities dealer, municipal advisor, transfer agent, or NRSRO are not impermissibly retroactive when the respondent has demonstrated unfitness for the securities industry that extends beyond his or her past or present industry associations. Such collateral bars, including bars from municipal advisors and NRSROs, are appropriately applied as "prospective remedies whose purpose is to protect the investing public from future harm."[84] Here, although Bartko's misconduct pre-dated Dodd-Frank, Bartko was not then associated with municipal advisors or NRSROs and he did not have a vested right to any such future association.[85]

Bartko cites *Gupta v. Securities and Exchange Commission*[86] and *Mart v. Gozdecki, Del Guidice, Americus & Farkas LLP*[87] to argue that none of Dodd-Frank's provisions may be

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81 *See Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1108 (D.C. Cir. 1988) (stating that "an attack on the validity of [an underlying] proceeding" that could have been raised in the earlier proceeding is "doomed to fail"); *Wolfson v. Baker*, 623 F.2d 1074, 1080–81 (5th Cir. 1980) (rejecting argument that prosecution withheld evidence because the underlying criminal proceeding afforded an opportunity to raise those objections).

82 2013 U.S. App. LEXIS 17914, at *32. *See* Petition for Review at 3 (stating that his *Brady* claims were addressed in the January 17 Order and that "[a]ll of these issues and more will be addressed in Respondent's appeal of his criminal conviction now pending before the United States Court of Appeals").

83 *See, e.g.*, *Jimmy Dale Swink, Jr.*, Exchange Act Rel. No. 36042, 52 SEC 379, 1995 SEC LEXIS 2033, at *2 (Aug. 1, 1995) (vacating bar upon reversal of underlying conviction).

84 2012 SEC LEXIS 3855, at *38. Although the Division did not appeal the law judge's refusal to impose a bar from association with any municipal advisor or NRSRO, we determined, on our own initiative, to review the sanctions pursuant to Rule of Practice 411(d). *See supra* note 32.

85 *See Kornman*, 592 F.3d at 188 (describing industry participation as "a privilege voluntarily granted" rather than a right (quoting *Hudson v. United States*, 522 U.S. 93, 104 (1997)).

86 796 F. Supp. 2d 503 (S.D.N.Y. 2011).

87 910 F. Supp. 2d 1085 (N.D. Ill. 2012).

applied in cases addressing conduct pre-dating the statute. But these cases are inapposite. *Gupta* addressed a motion for declaratory and injunctive relief in which Gupta argued, among other things, that the decision to institute an administrative proceeding authorized under Dodd-Frank Section 929P constituted an impermissibly retroactive application of Dodd-Frank, but the court ultimately declined even to reach the retroactivity issue.[88] *Mart* addressed a legal malpractice claim based on an attorney's failure to file a timely whistleblower lawsuit under Section 806 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). The decision dismissed the malpractice suit because it concluded that the whistleblower claim would not have succeeded even if timely filed. It found that the text of Sarbanes-Oxley Section 806 unambiguously excluded Mart, as the employee of a privately-held subsidiary of a public company, from its whistleblower protections. Mart noted that Dodd-Frank Section 929A later extended these protections to private subsidiary employees and argued that this amendment covered his pre-amendment whistleblower claim because it clarified an ambiguity in Sarbanes-Oxley. The court rejected this argument. Reasoning that the text of the original statute unambiguously excluded his pre-amendment claim, the court held that the Dodd-Frank amendment was an alteration, rather than clarification, of the whistleblower protections that could not be applied retroactively.

Neither decision addresses the collateral bars authorized in Dodd-Frank Section 925 or offers any legal analysis that is contrary to our conclusion in *Lawton* that Section 925 does not operate retroactively because it provides forward-looking remedies that target the risk of future misconduct. As we held in *Lawton*, our analysis in applying collateral bars is prospective: "[W]e consider the record evidence to determine whether [the collateral bar] 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."[89]

C. Bartko's conduct demonstrates the need for industry-wide bars.

The facts here demonstrate Bartko's unfitness and the risks he would pose to investors and the markets in each of the capacities covered by the collateral bar.[90] Bartko exercised a

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88 796 F. Supp. 2d at 513.

89 *Lawton*, 2012 SEC LEXIS 3855, at *32; *cf. Kornman*, 592 F.3d at 188 (bars may be appropriate for occupations presenting "opportunities for future misconduct"); *McCarthy*, 406 F.3d at 189 (finding that sanctioning 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 sanctions); *Paz v. SEC*, 566 F.3d 1172, 1175–76 (D.C. Cir. 2009) (indicating that the Commission must make "findings regarding the protective interests to be served" by a bar).

90 *See generally Lawton*, 2012 SEC LEXIS 3855, at *18 *et seq.* (finding collateral bar justified when respondent "reveal[ed] an attitude toward regulatory oversight that is fundamentally incompatible with the principles of investor protection"; violated professional responsibilities that are "not limited to a particular aspect of the securities industry"; and demonstrated "his ongoing unfitness and risk that he would engage in further misconduct if

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leadership role in the execution of the scheme. He formed the two investment funds to give his investment scheme a false impression of legitimacy; knowingly relied on fraudulent fundraising; acted as a liaison between co-conspirators; directed deposits and transfers of scheme funds; sent financial statements to investors as part of the scheme; structured the fraudulent transactions; and recruited additional participants to the conspiracy to maintain access to investor funds. Bartko's central role in organizing this complex and self-serving fraudulent scheme demonstrates his unfitness for associating in the industry in any capacity, each of which "presents a great many opportunities for abuse and overreaching, and depends very heavily on the integrity of its participants."[91]

A further exacerbating factor is that Bartko engaged in affinity fraud, which preys upon "the trust and friendship that exist[s] in groups of people who have something in common" to convince group members that "a fraudulent investment is legitimate and worthwhile."[92] Such frauds pose heightened risks to investors because they "can be difficult for regulators or law enforcement officials to detect," particularly where, as here, "the fraudsters have used respected community or religious leaders to convince others to join the investment."[93] Bartko's involvement in affinity fraud, which by definition exploits the trust of investors, is more than sufficient to demonstrate his unfitness to act as a fiduciary—either as an investment adviser or municipal advisor.[94]

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given future opportunities in the industry", where "opportunities for similar misconduct arise in each of the associational capacities covered by the collateral bar").

91 *Kornman*, 2009 SEC LEXIS 367, at *23 (also noting that "the importance of honesty for a securities professional is so paramount that we have barred individuals even when the conviction was based on dishonest conduct unrelated to securities transactions or securities business"); *Conrad P. Seghers*, Advisers Act Rel. No. 2656, 2007 SEC LEXIS 2238, at *28 (Sept. 26, 2007), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008) (noting that the securities industry "presents continual opportunities for dishonesty and abuse").

92 Affinity Fraud: How to Avoid Investment Scams That Target Groups, available at http://www.sec.gov/investor/pubs/affinity.htm.

93 *Id.*

94 Dodd-Frank § 975(c), 124 Stat. at 1851 (indicating that municipal advisors "shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts . . ."); *see also Lawton*, 2012 SEC LEXIS 3855, at *43 n.59 (finding that violating duties to clients demonstrates unfitness to take on "heightened responsibilities" as a fiduciary). *Cf. SEC v. Bankosky*, 716 F.3d 45, 49 (2d Cir. 2013) (finding that defendant "demonstrate[d] unfitness to serve as a corporate fiduciary" by engaging in "conduct betray[ing] an impulse to place self-interest ahead of" the interests of employer and shareholders); *SEC v. Gupta*, 11 Civ. 7566, 2013 U.S. Dist. LEXIS 102274, at *11 (S.D.N.Y. July 17, 2013) (permanently barring defendant

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Furthermore, all securities professionals "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."[95] Accordingly, securities professionals have heightened responsibilities to the investing public and must avoid temptations to fraudulently misuse such information and their expertise for "inappropriate—but potentially lucrative or self-serving—ends."[96] Bartko demonstrated an incapacity to exercise such restraint when he orchestrated a longstanding, self-serving, and egregious conspiracy that violated basic principles of market fairness and integrity that apply to all securities professionals.

Bartko repeatedly failed to respect the most basic limits on his own conduct and the conduct of his associates and sought to evade regulatory scrutiny, demonstrating 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."[97] He deliberately sought to avoid regulatory oversight and constraints both by transferring investor funds intended for the Caledonian Fund from an account subject to NASD audit to his lawyer trust account and by redirecting investor funds held by Capstone Equity through a purported investment club and then back into Capstone Equity to evade limits on non-accredited investor investments.[98] Even after Caledonian Fund depleted all of the investors' principal without generating any returns, Bartko extended the conspiracy by creating Capstone Equity and later the investment club.

Particularly troubling is Bartko's eagerness to extend and expand the scheme and rely on Hollenbeck to raise more than a million dollars from investors each month even after he knew that Hollenbeck had admitted to fraudulent and unregistered securities sales and had agreed to cease and desist from further fraudulent activities. Bartko also knew that Hollenbeck saw Bartko's conspiracy as an "alternative deployment vehicle" for continuing to raise funds from investors after he consented to the Mobile Billboards cease-and-desist order. Under these

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from serving as an officer or director of any publicly traded company and finding that his conduct "demonstrates unfitness to serve as a corporate fiduciary"); *Drinkard v. Walnut St. Sec., Inc.*, 3:09-cv-66-FDW, 2009 U.S. Dist. LEXIS 44016, at *9 (W.D.N.C. May 11, 2009) (finding that allegations of affinity fraud in which agents "actively exploited religious connections to establish trust and confidence, are sufficient to state a claim for breach of fiduciary duty").

95 *Lawton*, 2012 SEC LEXIS 3855, at *44.

96 *Id.*

97 *Id.* at *45.

98 *Brown & Jamerica*, 2011 SEC LEXIS 2073, at *22 (finding that respondent's "attempts to disguise his actions" support a bar); *Guy P. Riordan*, Exchange Act Rel. No. 61153, 2009 SEC LEXIS 4166 (Dec. 11, 2009) (finding that respondent's efforts to conceal and avoid detection supported a bar).

circumstances, Bartko's decision to expand the conspiracy, his reliance on Hollenbeck, and his apparent indifference to regulatory scrutiny of Hollenbeck's fraudulent sales techniques, confirm that Bartko's unfitness extends to all areas of the industry subject to investor protection standards, market fairness and integrity, and regulatory oversight.

Bartko also took advantage of his own knowledge of the securities industry and his securities-related activities to extend his scheme. For instance, he used his expertise to form the two funds, to send and process fraudulent offering and investment documents to further the scheme, and to repeatedly restructure the investment scheme. Even worse, he created a false semblance of legitimacy with investors by advising them that he was required to refund their money because, as non-accredited investors, their investments did not comply with securities regulations, while arranging for these refunds to be redirected into Capstone Equity through a different fraudulent vehicle, the investment club. Bartko also leveraged the information and relationships he formed as part of the conspiracy to generate other professional opportunities in the securities industry and, in turn, used his other securities-related professional activities to further the fraudulent scheme. For instance, in his capacity as an attorney, he represented his co-conspirator, Hollenbeck, in regulatory investigations of fraudulent sales tactics for Mobile Billboards similar to those that Bartko knew that Hollenbeck was employing for Caledonian Fund, and then recruited Hollenbeck and other individuals involved in the Mobile Billboards lawsuit and investigations to support Capstone Equity and the investment club.

Bartko argues that the law judge failed to consider as mitigating his purported cooperation with a June 28, 2005 Commission staff examination of Capstone BD. But this examination, which took place after the conspiracy, mail fraud, and unregistered securities sales had ended and purportedly before Bartko became aware of an investigation of his own conduct, is not mitigating in light of the seriousness of his crimes and the numerous steps Bartko took to evade regulatory scrutiny before the Commission staff learned about Capstone Equity.

Bartko also argues that the bars are punitive because the law judge failed to consider lesser sanctions, because he is not currently registered in the securities industry, and because imprisonment prevents him from engaging in professional activities. While Bartko's current circumstances limit his securities-related activities, we are not persuaded that they render bars inappropriate given the gravity of the threat he presents to investors.[99] Bartko had a history of associating in the securities industry in multiple capacities over more than fifteen years and demonstrated his propensity to repeatedly devise new ways to defraud investors, obscure his involvement in fraud, and expand an ongoing conspiracy despite regulatory scrutiny of his co-conspirator. His resourcefulness and audacity in using his securities industry association to generate new opportunities to defraud investors and evade regulatory constraints under these

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99 *See Paz*, 566 F.3d at 1176; *Horning v. SEC*, 570 F.3d 337, 346 (D.C. Cir. 2009) (holding that Commission need not state why a lesser sanction would be insufficient); *cf. Kornman*, 592 F.3d at 188 (finding summary disposition appropriate when the respondent "presented no ground for an evidentiary hearing on mitigation").

circumstances, and his continuing insistence that he did nothing wrong, confirm a serious risk that he would seek to return to the industry and pursue opportunities to enrich himself at the expense of investors and the markets in any capacity left open to him.

Bartko's pattern of using his securities industry association for his own fraudulent and self-interested ends demonstrates that "allowing him to enter the securities industry in *any capacity* would create too great a risk" to the securities markets and investors to be permitted.[100]

D. Bartko's claims of prosecutorial misconduct are unavailing.

Throughout the proceeding, Bartko has claimed that his conviction resulted from misconduct and improper collusion between regulatory authorities. For instance, he argues that Commission staff acted improperly during a March 2005 discussion with FINRA and used a June 28, 2005 examination of Capstone BD to "dupe[]" him into turning over materials as part of a "collusive investigation" by the Division and the United States Attorney's Office that "severely prejudiced him at his criminal trial" and was a "clear violation of due process."[101] We have already explained that this is not an appropriate forum for raising these matters.

Bartko's procedural claims are similarly off base. Bartko argues that (a) his claims should be considered mitigating for purposes of the sanctions determination; (b) summary disposition was improperly granted because he was entitled to a hearing to develop his claims of prosecutorial misconduct; (c) the Commission should be precluded, under the doctrine of unclean hands, from enforcing follow-on remedies based on his criminal convictions; and (d) he was improperly denied discovery from the Division's files to bolster his claims of prosecutorial misconduct.

Bartko's claims of prosecutorial misconduct neither mitigate the seriousness of his own misconduct nor lessen the public interest in preventing his future association in the industry. We are mindful of the need to address potential mitigating factors and the "remedial and protective efficacy" of sanctions involving expulsion from the securities industry.[102] But Bartko's claims are not mitigating in the administrative proceedings because our *Steadman* analysis properly focuses on the risk that Bartko poses to investors and the integrity of the securities markets—not on the propriety of the investigation prior to his conviction.[103]

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100 *Lawton*, 2012 SEC LEXIS 3855, at *47 (emphasis in original).

101 Resp't Br. at 9–10; Reply Br. at 7.

102 *Cf. Saad v. SEC*, 718 F.3d 904 (D.C. Cir. 2013); *McCarthy v. SEC*, 406 F.3d at 190; *but see Paz* 566 F.3d at 1176 (stating that a bar from association with any SRO member firm does not require the Commission to "state why a lesser sanction would be insufficient").

103 *Kornman*, 2009 SEC LEXIS 367, at *36.

Bartko claims that "the misconduct of Division staff and that of Respondent's federal prosecutors goes directly to the heart of [his] state of mind" during the relevant period.[104] But his state of mind was litigated during the criminal trial.[105] Bartko does not explain, nor can we find, a plausible connection between his claims of prosecutorial misconduct and his own scienter while engaging in the criminal conspiracy and mail fraud for which he was convicted—particularly because Bartko claims that he was not aware of the purported collusion between Commission, United States Attorney's Office, and FINRA staff when it took place. Moreover, Bartko began organizing the scheme in January 2004—before he formed either of the two funds and well before any possible regulatory investigation of the scheme he led through those funds.

Bartko's other arguments about the alleged prosecutorial misconduct are also misplaced. Bartko erroneously argues that the law judge erred by failing to accept as true his claims of prosecutorial misconduct and collusion. Rule 250(b) authorizes summary disposition "if there is no genuine issue with regard to any material fact."[106] Summary disposition on sanctions is appropriate when, as in this case, the respondent has failed to establish a genuine issue concerning mitigation. As discussed, Bartko's claims, even taken as true, are not mitigating.[107]

We are similarly unpersuaded by Bartko's unclean hands defense. The doctrine of unclean hands is not generally available in a Commission action when, as here, the Commission is "attempting to enforce a congressional mandate in the public interest."[108] Courts recognize

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104 Petition for Review at 4.

105 *See supra* text accompanying note 70. Moreover, as the January 17 Order explained, "the trial focused on Bartko's knowledge, intent, and good faith" and it concluded that there was ultimately overwhelming evidence of Bartko's guilt.

106 17 C.F.R. § 201.250.

107 *Cf. Gibson v. SEC*, 561 F.3d 548 (6th Cir. 2009) (finding the Commission did not abuse its discretion in considering the *Steadman* factors and mitigating evidence to impose a bar).

108 *Franklin*, 2007 SEC LEXIS 2420, at *13; *accord Harold F. Harris*, Exchange Act Rel. No. 53122, 2006 SEC LEXIS 68, at *23 n. 28 and accompanying text (Jan. 13, 2006), citing *SEC v. KPMG LLP*, 03 Civ. 671, 2003 U.S. Dist. LEXIS 14301, at *8 (S.D.N.Y. Aug. 20, 2003); *SEC v. Rosenfeld*, 97 Civ. 1467, 1997 U.S. Dist. LEXIS 10159, at *5 (S.D.N.Y. July 16, 1997); *see also SEC v. Lorin*, 90 Civ. 7461, 1991 WL 576895, at *1 (S.D.N.Y. June 18, 1991) ("Generally, an unclean hands defense is not available in a SEC enforcement action."); *SEC v. Condron*, Civ. No. B-85-87, 1985 U.S. Dist. LEXIS 19046, at *1 (D. Conn. June 10, 1985) ("Unclean hands is not a defense against an action sought by the SEC."); *see generally Heckler v. Cmty. Health Servs., Inc.*, 467 U.S. 51, 60 (1984) (stating that "[w]hen the Government is unable to enforce the law because the conduct of its agents has given rise to an estoppel, the interest of the citizenry as a whole in obedience to the rule of law is undermined").

"the need to deter governmental abuses,"[109] but in order to raise this equitable defense against a government agency, courts "have required that the agency's misconduct be egregious and the resulting prejudice to the defendant rise to a constitutional level."[110] Bartko has not articulated how Commission staff prevented him from properly defending himself in the criminal proceeding. In any case, the appropriate forum for any constitutional challenge to the conviction was through his criminal appeal, and the appellate court did not find constitutional prejudice in this case.

Nor are we persuaded that Bartko is entitled to discovery in this proceeding to substantiate his prosecutorial misconduct theory. Bartko argues that the Division staff should be required under Rule 230 to "search[] its records to determine if there were documents that were responsive to Bartko's requests outside of the rubric of the 'investigative file'" and turn over any such records.[111] He also argues that the Division had a duty to "make inquiry of other federal agencies," including of the United States Attorney's Office, and that the law judge improperly declined to subpoena these materials.[112]

We have already concluded that Bartko's allegations of prosecutorial misconduct are not relevant to our sanctions determination and that the criminal trial and appeal process—not this proceeding—was the proper forum for developing his challenges to the criminal charges. Moreover, Bartko cites no authority indicating that Rule 230 requires discovery beyond the investigative file or inquiries of other government agencies, nor are we aware of any such authority.[113] Nor has Bartko demonstrated any impropriety in the rejection of his subpoena

109 *Lorin*, 1991 WL 576895, at *1 ("Recognizing the need to deter governmental abuses, courts do allow the defense of government misconduct to be invoked where it appears that the government may have engaged in outrageous or unconstitutional activity.").

110 *SEC v. Follick*, 00 Civ. 4385, 2002 U.S. Dist. LEXIS 24112, at *23 (S.D.N.Y. Dec. 18, 2002) (quoting *SEC v. Elecs. Warehouse, Inc.*, 689 F. Supp. 53, 73 (D. Conn. 1988), *aff'd*, 891 F.2d 457 (2d Cir. 1989)); *see also SEC v. Cuban*, 798 F. Supp. 2d 783, 794 (N.D. Tex. 2011) (finding that to the extent the defense of unclean hands is available in an SEC enforcement action, it is only in "strictly limited circumstances" when, among other things, "the misconduct . . . result[s] in prejudice to the defense of the enforcement action that rises to a constitutional level and is established through a direct nexus between the misconduct and the constitutional injury").

111 Reply at 3.

112 *Id.* at 4.

113 *See Kornman*, 2009 SEC LEXIS 367, at *50 n.70 (noting that Rule 230 applies to "existing information in the Division's investigative file, but [not] to new discovery" sought by the respondent); *id.* at *48 (finding that law judge properly rejected attempts during a follow-on proceeding to "seek information supporting Kornman's allegations as to Commission staff misconduct during the criminal matter"); *cf. Scott Epstein*, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217, at *61 n.54 (Jan 30, 2009) (noting that respondent "is not 'entitled to conduct a

(continued...)

request under Rule 232, which grants the law judge discretion to decide such requests.[114] In any event, trial transcript excerpts that Bartko attached to his brief suggest that he had the chance to develop his misconduct and collusion claims during the criminal trial, where he questioned Commission staff about their interactions with Bartko and with other regulators. And the Fourth Circuit appeal of the criminal case was the appropriate forum to further pursue those concerns, which Bartko had the opportunity to do. That court has issued its opinion and, notwithstanding its concern with the discovery practices in the United States Attorney's Office in the Eastern District of North Carolina, the court found that the discovery issues in the criminal case did not undermine confidence in the jury verdict.

* * *

Bartko's conduct demonstrates his fundamental unfitness for the securities marketplace and that his future association in the industry in any capacity would unduly risk 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.'"[115] We find that the record demonstrates Bartko's inability to uphold such ethical standards, which are required throughout the industry. We therefore find that barring Bartko from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or NRSRO serves the public interest and is remedial.

(continued...)

fishing expedition . . . in an effort to discover something that might assist him in his defense'. . . or 'in the hopes that some evidence will turn up to support an otherwise unsubstantiated theory'" (internal citations omitted)). As a result, we find Bartko is mistaken in his contention that the Division was obligated under Rule 230 to search beyond the investigative file for this follow-on proceeding, to make a separate inquiry to "other federal agencies connected to the investigation giving rise to the issuance of the OIP," including the United States Attorney's Office that criminally prosecuted Bartko, and to gather "a compendium of documents used in Bartko's prosecution" in search of *Brady* material.

114 *See* Rule of Practice 232(b), 17 C.F.R. § 201.232(b); *Barr Financial Group, Inc.*, Advisers Act Rel. No. 2179, 56 SEC 1243, 2003 SEC LEXIS 2340, at *29 (Oct. 2, 2003) (affirming a law judge decision to decline a subpoena request under the "unreasonable, oppressive, excessive in scope, or unduly burdensome" standard).

115 *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 315 (1985) (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186–87 (1963)).

An appropriate order will issue.[116]

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN); Commissioners GALLAGHER and PIWOWAR, 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
Secretary

By: Lynn M. Powalski
Deputy Secretary

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 71666 / March 7, 2014

Admin. Proc. File No. 3-14700

In the Matter of
GREGORY BARTKO

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Gregory Bartko is hereby barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

Chair White, Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71676 / March 10, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3789 / March 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15777

In the Matter of **HENRY MORRIS,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND RULE 102(e)(2) 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 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Henry Morris ("Respondent"). The Commission also deems it appropriate to issue an order of forthwith suspension of Respondent pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)(2)].[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, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities

[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."

Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, and Rule 102(e)(2) 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. Respondent, age 59, is incarcerated in New York State. From May 2003 through August 2008, Respondent was a registered representative associated with Searle & Co., a registered broker-dealer and investment adviser based in Greenwich, Connecticut. While working at Searle, he held Series 7 and 63 licenses. Respondent was admitted to practice law in the State of New York on June 20, 1979. Respondent was disbarred on November 22, 2010.

2. On March 19, 2009, the Commission filed a civil action against Respondent in the United States District Court for the Southern District of New York, SEC v. Henry Morris, et al., Civil Action No. 09-CV-2518. The Commission's complaint alleges, inter alia, that in connection with the sale of securities to the New York Common Retirement Fund ("Retirement Fund") and the investment of Retirement Fund assets in the purchase and sale of securities, Respondent knowingly engaged in a fraudulent scheme involving undisclosed kickback payments made by investment management firms to Respondent and others.

3. On November 22, 2010, Respondent pled guilty to a felony violation of the Martin Act, New York General Business Law § 352-c(6), before the Supreme Court of the State of New York, County of New York, The People of the State of New York vs. Henry "Hank" Morris, Indictment No. 25/2009. On February 17, 2011, a judgment of conviction in the criminal case was entered against Respondent. He was sentenced to a term of imprisonment of one and one-third years to four years and ordered to pay restitution in the amount of $19,000,000.

4. On March 3, 2014, the United States District Court for the Southern District of New York entered, by consent, a final judgment against Respondent permanently enjoining him from future violations of Sections 17(a) of the Securities Act of 1933, 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Advisers Act.

IV.

In view of the foregoing, the Commission finds that Respondent has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice and 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 be, and hereby is (i) barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and (ii) 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 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.

It is hereby further ORDERED pursuant to Rule 102(e)(2) of the Commission's Rules of Practice that Respondent is forthwith suspended from appearing or practicing before the Commission.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Chair White
Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71676A / March 10, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3789 / March 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15777

In the Matter of **HENRY MORRIS,** **Respondent.**	**CORRECTED ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND RULE 102(e)(2) 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 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Henry Morris ("Respondent"). The Commission also deems it appropriate to issue an order of forthwith suspension of Respondent pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)(2)].[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, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities

[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."

Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, and Rule 102(e)(2) 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. Respondent, age 59, is incarcerated in New York State. From May 2003 through August 2008, Respondent was a registered representative associated with Searle & Co., a registered broker-dealer and investment adviser based in Greenwich, Connecticut. While working at Searle, he held Series 7 and 63 licenses. Respondent was admitted to practice law in the State of New York on June 20, 1979. Respondent was disbarred on November 22, 2010.

2. On March 19, 2009, the Commission filed a civil action against Respondent in the United States District Court for the Southern District of New York, SEC v. Henry Morris, et al., Civil Action No. 09-CV-2518. The Commission's complaint alleges, inter alia, that in connection with the sale of securities to the New York Common Retirement Fund ("Retirement Fund") and the investment of Retirement Fund assets in the purchase and sale of securities, Respondent knowingly engaged in a fraudulent scheme involving undisclosed kickback payments made by investment management firms to Respondent and others.

3. On November 22, 2010, Respondent pled guilty to a felony violation of the Martin Act, New York General Business Law § 352-c(6), before the Supreme Court of the State of New York, County of New York, The People of the State of New York vs. Henry "Hank" Morris, Indictment No. 25/2009. On February 17, 2011, a judgment of conviction in the criminal case was entered against Respondent. He was sentenced to a term of imprisonment of one and one-third years to four years and ordered to pay restitution in the amount of $19,000,000.

4. On March 3, 2014, the United States District Court for the Southern District of New York entered, by consent, a final judgment against Respondent permanently enjoining him from future violations of Sections 17(a) of the Securities Act of 1933, 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Advisers Act.

IV.

In view of the foregoing, the Commission finds that Respondent has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice and 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 be, and hereby is (i) barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and (ii) 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 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.

It is hereby further ORDERED pursuant to Rule 102(e)(2) of the Commission's Rules of Practice that Respondent is forthwith suspended from appearing or practicing before the Commission.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

Chair White
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71677 / March 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15778

In the Matter of **DAVID LOGLISCI,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTION**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)(2)] against Respondent David Loglisci ("Respondent").[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, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e)(2) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanction ("Order"), as set forth below.

[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."

III.

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

1. Respondent, age 41, resides in Oklahoma City, Oklahoma. Beginning in 2003, he served as the Director of Alternative Investments for the Comptroller of the State of New York. In April 2004, Respondent was promoted to Deputy Comptroller and Chief Investment Officer and served in that position until his resignation in mid-2007. Respondent was admitted to practice law in the State of New York on June 23, 1999. Respondent was disbarred on March 10, 2010.

2. On March 19, 2009, the Commission filed a civil action against Respondent in the United States District Court for the Southern District of New York, SEC v. Henry Morris, et al., Civil Action No. 09-CV-2518, and subsequently amended the complaint on three occasions. The Commission's Third Amended Complaint ("Complaint") alleges, inter alia, that in connection with the sale of securities to the New York Common Retirement Fund ("Retirement Fund") and the investment of Retirement Fund assets in the purchase and sale of securities, Respondent knowingly engaged in a fraudulent scheme involving undisclosed kickback payments made by investment management firms to Henry Morris and others.

3. On March 10, 2010, Respondent pled guilty to a felony violation of the Martin Act, New York General Business Law § 352-c(6), before the Supreme Court of the State of New York, County of New York, The People of the State of New York vs. David Loglisci, Indictment No. 25/2009. On October 9, 2012, a judgment of conviction in the criminal case was entered against Respondent, and he was sentenced to conditional discharge.

4. On March 3, 2014, the United States District Court for the Southern District of New York entered, by consent, a final judgment against Respondent permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Investment Advisers Act of 1934.

IV.

In view of the foregoing, the Commission finds that Respondent has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice and deems it appropriate to impose the sanction agreed to in Respondent's Offer.

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

By the Commission.

Jill M. Peterson
Assistant Secretary

Chair White
Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71678 / March 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15779

In the Matter of **JULIO RAMIREZ, JR.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Julio Ramirez, Jr. ("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, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

13 of 63

III.

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

1. Respondent, age 51, resides in San Marino, California. From September 2005 through April 2009, Respondent was a managing director of Park Hill Group LLC, a registered broker dealer. From 2002 through early 2005, Respondent was a principal of Wetherly Capital Group, LLC, an investment banking and consulting firm. During the periods noted above, Respondent held Series 7 and 63 licenses.

2. On May 12, 2009, the Commission filed a Third Amended Complaint ("Complaint") naming Respondent as a defendant in a civil action pending in the United States District Court for the Southern District of New York, SEC v. Morris, et al., Civil Action No. 09-CV-2518. The Commission's Complaint alleges, inter alia, that, in connection with the sale of securities to the New York Common Retirement Fund ("Common Fund") and the investment of Common Fund assets in the purchase and sale of securities, Respondent participated in a fraudulent scheme involving undisclosed kickback payments made by investment management firms to Respondent and others.

3. On May 13, 2009, Respondent pled guilty to a misdemeanor violation of the Martin Act, New York General Business Law § 352-c(4), before the New York City Criminal Court, County of New York, The People of the State of New York vs. Julio Ramirez, Jr., Misdemeanor Complaint number M09620814. On January 19, 2012, a judgment in the criminal case was entered against Respondent. He was sentenced to a conditional discharge, requiring compliance with a consent order and forfeiture of $289,875.

4. In connection with that plea, Respondent admitted that between 2003 and 2006, he engaged in a fraudulent scheme to obtain payments from investment management firms seeking to manage investment assets held by the New York State Common Retirement Fund ("Retirement Fund"). Respondent further admitted, among other things, that as a result of these arrangements, Retirement Fund assets were invested with private equity firms and hedge fund managers for the undisclosed purpose of enriching Respondent and others.

5. On March 3, 2014, the United States District Court for the Southern District of New York entered, by consent, a final judgment against Respondent permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Investment Advisers Act of 1940.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock

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

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

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Chair White
Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71678A / March 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15779

In the Matter of JULIO RAMIREZ, JR., Respondent.	**CORRECTED ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Julio Ramirez, Jr. ("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, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Respondent, age 51, resides in San Marino, California. From September 2005 through April 2009, Respondent was a managing director of Park Hill Group LLC, a registered broker dealer. From 2002 through early 2005, Respondent was a principal of Wetherly Capital Group, LLC, an investment banking and consulting firm. During the periods noted above, Respondent held Series 7 and 63 licenses.

2. On May 12, 2009, the Commission filed a Third Amended Complaint ("Complaint") naming Respondent as a defendant in a civil action pending in the United States District Court for the Southern District of New York, SEC v. Morris, et al., Civil Action No. 09-CV-2518. The Commission's Complaint alleges, inter alia, that, in connection with the sale of securities to the New York Common Retirement Fund ("Common Fund") and the investment of Common Fund assets in the purchase and sale of securities, Respondent participated in a fraudulent scheme involving undisclosed kickback payments made by investment management firms to Respondent and others.

3. On May 13, 2009, Respondent pled guilty to a misdemeanor violation of the Martin Act, New York General Business Law § 352-c(4), before the New York City Criminal Court, County of New York, The People of the State of New York vs. Julio Ramirez, Jr., Misdemeanor Complaint number M09620814. On January 19, 2012, a judgment in the criminal case was entered against Respondent. He was sentenced to a conditional discharge, requiring compliance with a consent order and forfeiture of $289,875.

4. In connection with that plea, Respondent admitted that between 2003 and 2006, he engaged in a fraudulent scheme to obtain payments from investment management firms seeking to manage investment assets held by the New York State Common Retirement Fund ("Retirement Fund"). Respondent further admitted, among other things, that as a result of these arrangements, Retirement Fund assets were invested with private equity firms and hedge fund managers for the undisclosed purpose of enriching Respondent and others.

5. On March 3, 2014, the United States District Court for the Southern District of New York entered, by consent, a final judgment against Respondent permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Investment Advisers Act of 1940.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent be, and hereby is:

> 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 any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock

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

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

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9557 / March 11, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71688 / March 11, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3542 / March 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15783

In the Matter of **Clayton T. Marshall,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, 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 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Clayton T. Marshall ("Marshall" or "Respondent") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[1]

[1] Section 4C provides, in relevant part, that:
The Commission may . . . deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . 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)(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.

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 and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, 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 and Notice of Hearing ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that

Respondent

1. **Clayton T. Marshall**, age 37, is a resident of Grand Junction, CO. He joined AgFeed Industries, Inc. in September 2010 as a divisional chief financial officer ("CFO"). He then served as AgFeed's CFO from July 15, 2011 until August 2012, when he left the company. Marshall has a bachelor's degree in accounting and is not a certified public accountant.

Other Relevant Entity

2. **AgFeed Industries, Inc.** ("AgFeed" or "the Company"), is a Nevada corporation with its principal place of business in Hendersonville, TN. At all relevant times, AgFeed was an animal nutrition and hog production company with operations in China and the United States. On July 15, 2013, AgFeed filed a Chapter 11 bankruptcy petition and is currently in liquidation. Until February 2012, AgFeed's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act. At all relevant times, AgFeed's stock was quoted on The NASDAQ Stock Market LLC, until the company was delisted on March 24, 2012. AgFeed's stock is currently quoted on OTC Link operated by OTC Markets Group Inc.

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

Facts

3. From approximately mid-2008 through June 30, 2011, AgFeed's publicly-reported revenues were inflated falsely by approximately $239 million due to actions by former members of AgFeed's Chinese management including, among other things, inflating revenues by booking sales of non-existent hogs and manipulating hog weights, and later covering it up by, among other things, reporting that the fake hogs had died.

4. In September 2010, AgFeed began a plan of expansion by merging with a privately-held U.S. company. Respondent, who had no prior experience with Commission-reporting companies, joined AgFeed as part of the merger. By approximately early June 2011, Respondent was generally aware that allegations of fraud had been reported regarding operations in the Jiangxi region, one of the five Chinese regions where AgFeed maintained hog farms, and that the Company was investigating the fraud allegations.

5. In or about mid-June 2011, Respondent, and others, learned of a new report of fraud allegations regarding operations in another AgFeed Chinese region (the Fujian region). Among other things, the report alleged that the Company had recorded false revenues and inflated fixed assets. Thereafter, Respondent knew or should have known that AgFeed failed to undertake a meaningful investigation regarding the Fujian region fraud allegations. Further, Respondent knew or should have known that the Company, following a limited review of its fixed assets, was unable to substantiate its fixed asset values. Further, Respondent learned that information had been discovered relating to the maintenance of two sets of accounting books in the Company's China operations. Respondent, even after he was promoted on July 15, 2011 to CFO of the Company, did not ensure that appropriate action was taken to determine whether AgFeed's current or prior financial statements were accurate.

6. On August 2, 2011, AgFeed published its earnings release for the period ended June 30, 2011. Respondent knew or should have known that AgFeed's financial statements included therein were false and misleading.

7. On August 9, 2011, Respondent signed the Company's management representation letter to AgFeed's independent auditor. The management representation letter was materially false or misleading as it, among other things, failed to disclose the fraud allegations relating to the Fujian region.

8. On August 9, 2011, AgFeed filed with the Commission the Company's Form 10-Q for the period ended June 30, 2011 (the "Form 10-Q"), which Respondent signed and certified as CFO. The Form 10-Q was incorporated into the Company's active June 2009 Form S-3 registration statement. The Form 10-Q also incorporated by reference the Company's Form 10-K for the period ended December 31, 2010. Respondent knew or should have known that the Company's Form 10-Q for the period ended June 30, 2011 was false and misleading.

9. On December 19, 2011, AgFeed finally disclosed that "financial accounting staff and management based in China engaged in accounting improprieties" and that "the Company's previously issued unaudited financial statements for the quarters ended March 31 and June 30, 2011, as well as its audited financial statements for the years ended December 31, 2010 and 2009, should be restated. As a result, the Company's consolidated balance sheets as of March 31 and June 30, 2011 and December 31, 2010 and 2009, the Company's consolidated statements of operations and other comprehensive income (loss) for the quarters ended March 31 and June 30, 2011 and the years ended December 31, 2010 and 2009, the Company's consolidated statements of cash flows for the quarters ended March 31 and June 30, 2011 and the years ended December 31, 2010 and 2009 and the footnotes thereto should no longer be relied upon." On January 31, 2012, AgFeed further disclosed that due to the "accounting irregularities" in China, "the Company's audited financial statements for the year ended December 31, 2008 should no longer be relied upon."

Violations

10. Section 17(a)(2) of the Securities Act prohibits any person from obtaining money or property by means of untrue statement of material facts or omissions, in the offer or sale of securities. Section 17(a)(3) of the Securities Act proscribes "any transaction, practice or course of business which operates or would operate as a fraud or deceit..." in the offer or sale of securities. A violation of these provisions may be established by a showing of negligence. Aaron v. SEC, 446 U.S. 680, 697 (1980).

11. Section 13(a) of the Exchange Act and Rule 13a-13 thereunder require issuers of securities registered pursuant to Section 12 of the Exchange Act, such as AgFeed, to file with the Commission accurate quarterly reports. Rule 12b-20 of the Exchange Act requires that these reports contain such further material information as may be necessary to make the required statements in the reports not misleading. Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Exchange Act Rule 13b2-1 prohibits any person from directly or indirectly falsifying, or causing to be falsified, any book or record subject to Section 13(b)(2)(A). Section 13(b)(2)(B) of the Exchange Act requires reporting companies to devise and maintain an adequate system of internal accounting controls. Rule 13b2-2 of the Exchange Act prohibits officers and directors from, directly or indirectly, making or causing to be made materially false or misleading statements or omissions to accountants in connection with an audit or preparation of reports to be filed with the Commission. Rule 13a-14 of the Exchange Act requires that the principal executive and financial officers certify each periodic report containing financial statements filed by an issuer pursuant to Section 13(a) of the Exchange Act.[3]

[3] Under Section 302 of the Sarbanes-Oxley Act of 2002, the principal executive and financial officers are required to certify, among other things, that: (1) they reviewed annual and quarterly reports; (2) based upon their knowledge, the report does not omit or misstate a material fact; and (3) they had disclosed any fraud, whether or not material, involving management to the audit committee and the auditors.

12. As a result of the conduct described above, Marshall willfully[4] violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Rules 13a-14, 13b2-1 and 13b2-2 under the Exchange Act, and was a cause of AgFeed's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

IV.

13. Pursuant to this Order, Respondent agrees to additional proceedings in this proceeding to determine what, if any, civil penalties pursuant to Section 8A(g) of the Securities Act and Section 21B(a) of the Exchange Act against Respondent are in the public interest. In connection with such additional proceedings: (a) Respondent agrees that he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 4C and 21C of the Exchange Act, and Rule 102(e)(1)(iii) of the Commission's Rules of Practice it is hereby ORDERED that:

A. Respondent Marshall shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 13a-13, 13a-14, 13b2-1, 13b2-2 and 12b-20 promulgated thereunder.

B. Respondent Marshall is denied the privilege of appearing or practicing before the Commission as an accountant.

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

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[4] 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)).

D. IT IS FURTHER ORDERED pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party, that a public hearing for the purpose of taking evidence on the questions set forth in Section IV 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, following the entry of a final judgment against the last remaining defendant(s) in Securities and Exchange Commission v. AgFeed Industries, Inc., et al. (M.D. TN) (the "Related Actions").

If Marshall fails to appear at a hearing after being duly notified, Marshall 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 Marshall personally or by certified mail.

E. IT IS FURTHER ORDERED pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party, that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of the entry of a final judgment in the Related Actions.

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.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9556 / March 11, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71687 / March 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15782

In the Matter of **John A. Stadler** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against John A. Stadler ("Stadler" or "Respondent") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act").

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 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. **John A. Stadler**, age 70, is a resident of Cape Coral, Florida. He joined AgFeed Industries, Inc. in September 2010 as a director. He then served as AgFeed's chairman and interim chief executive officer ("interim CEO") from February 2011 until December 2011, when he left the company.

Other Relevant Entity

2. **AgFeed Industries, Inc.** ("AgFeed" or "the Company"), is a Nevada corporation with its principal place of business in Hendersonville, TN. At all relevant times, AgFeed was an animal nutrition and hog production company with operations in China and the United States. On July 15, 2013, AgFeed filed a Chapter 11 bankruptcy petition and is currently in liquidation. Until February 2012, AgFeed's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act. At all relevant times, AgFeed's stock was quoted on The NASDAQ Stock Market LLC, until the company was delisted on March 24, 2012. AgFeed's stock is currently quoted on OTC Link operated by OTC Markets Group Inc.

Facts

3. From approximately mid-2008 through June 30, 2011, AgFeed's publicly-reported revenues were inflated falsely by approximately $239 million due to actions by former members of AgFeed's Chinese management including, among other things, inflating revenues by booking sales of non-existent hogs and manipulating hog weights, and later covering it up by, among other things, reporting that the fake hogs had died.

4. In September 2010, AgFeed began a plan of expansion by merging with a privately-held U.S. company. Respondent joined AgFeed as part of the merger. By approximately early June 2011, Respondent was aware that fraud had been reported regarding operations in the Jiangxi region, one of the five Chinese regions where AgFeed maintained hog farms. Company management preliminarily investigated the fraud reports and, as a result, Respondent, and others, learned that former and current Chinese management, including the former CEO and former chief financial officer, had recorded false revenues in Jiangxi and maintained a second set of accounting books for the purpose of inflating revenue and profits. Respondent also learned that the Company obtained a physical copy of a portion of the two sets of books on a USB drive (the "USB Drive").

[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.

Information obtained during the preliminary investigation was provided to Respondent in a memorandum (the "Jiangxi Memo").

5. Respondent knew or was reckless in not knowing that AgFeed failed to undertake certain investigative steps regarding the Jiangxi region fraud report, such as hiring a professional firm to analyze the USB Drive. Respondent also failed to ensure that the Jiangxi Memo and the USB Drive were provided to the Company's independent auditor.

6. In or about mid-June 2011, Respondent, and others, learned of a new report of fraud allegations regarding operations in another AgFeed Chinese region (the Fujian region) that corroborated the Jiangxi region fraud report. Among other things, the report alleged that the Company had recorded false revenues and inflated fixed assets. Respondent knew or was reckless in not knowing that AgFeed failed to undertake a sufficient investigation regarding the Fujian region fraud allegations. Further, Respondent knew or was reckless in not knowing that the Company, following a limited review of its fixed assets, was unable to substantiate its fixed asset values. Further, Respondent learned that additional information had been discovered by a consultant to the Company relating to the maintenance of two sets of accounting books in the Company's China operations that further corroborated, among other things, the previous reports of a second set of books. Respondent, however, did not ensure that appropriate action was taken to determine whether AgFeed's current or prior financial statements were accurate. Respondent also failed to ensure that the Fujian report and the consultant's discovery relating to the two sets of books were provided to the Company's independent auditor.

7. On July 15, 2011, AgFeed published a press release, reviewed and approved by Respondent, touting the Company's "transformation, development, and growth" and expected revenues following certain expansion efforts. On July 18, 2011 and August 2, 2011, AgFeed published investor and shareholder presentations on Forms 8-K signed by Respondent, containing historical and projected revenues for the Company. On August 2, 2011, AgFeed published its earnings release for the period ended June 30, 2011. Respondent knew or was reckless in not knowing that these releases were false and misleading.

8. On August 9, 2011, Respondent signed the Company's management representation letter to AgFeed's independent auditor. The management representation letter was materially false or misleading as it, among other things, failed to provide the auditor with sufficient information about the reports of fraud in the Jiangxi and Fujian regions.

9. On August 9, 2011, AgFeed filed with the Commission the Company's Form 10-Q for the period ended June 30, 2011 (the "Form 10-Q"), which Respondent signed and certified as interim CEO. The Form 10-Q was incorporated into the Company's active June 2009 Form S-3 registration statement. The Form 10-Q also incorporated by reference the Company's Form 10-K for the period ended December 31, 2010. Respondent knew or was reckless in not knowing that the Company's Form 10-Q for the period ended June 30, 2011 was false and misleading.

10. On December 19, 2011, AgFeed finally disclosed that "financial accounting staff and management based in China engaged in accounting improprieties" and that "the

Company's previously issued unaudited financial statements for the quarters ended March 31 and June 30, 2011, as well as its audited financial statements for the years ended December 31, 2010 and 2009, should be restated. As a result, the Company's consolidated balance sheets as of March 31 and June 30, 2011 and December 31, 2010 and 2009, the Company's consolidated statements of operations and other comprehensive income (loss) for the quarters ended March 31 and June 30, 2011 and the years ended December 31, 2010 and 2009, the Company's consolidated statements of cash flows for the quarters ended March 31 and June 30, 2011 and the years ended December 31, 2010 and 2009 and the footnotes thereto should no longer be relied upon." On January 31, 2012, AgFeed further disclosed that due to the "accounting irregularities" in China, "the Company's audited financial statements for the year ended December 31, 2008 should no longer be relied upon."

Violations

11. Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

12. Section 13(a) of the Exchange Act and Rules 13a-11 and 13a-13 thereunder require issuers of securities registered pursuant to Section 12 of the Exchange Act, such as AgFeed, to file with the Commission accurate current and quarterly reports. Rule 12b-20 of the Exchange Act requires that these reports contain such further material information as may be necessary to make the required statements in the reports not misleading. Section 13(b)(5) of the Exchange Act prohibits any person from knowingly circumventing or falsifying any book, record, or account described in Section 13(b)(2) of the Exchange Act. Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Exchange Act Rule 13b2-1 prohibits any person from directly or indirectly falsifying, or causing to be falsified, any book or record subject to Section 13(b)(2)(A). Section 13(b)(2)(B) of the Exchange Act requires reporting companies to devise and maintain an adequate system of internal accounting controls. Rule 13b2-2 of the Exchange Act prohibits officers and directors from, directly or indirectly, making or causing to be made materially false or misleading statements or omissions to accountants in connection with an audit or preparation of reports to be filed with the Commission. Rule 13a-14 of the Exchange Act requires that the principal executive and financial officers certify each periodic report containing financial statements filed by an issuer pursuant to Section 13(a) of the Exchange Act.[2]

13. As a result of the conduct described above, Stadler violated Section 17(a) of the Securities Act and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14, 13b2-1, and 13b2-2 thereunder, and was a cause of AgFeed's violations of Sections 13(a),

[2] Under Section 302 of the Sarbanes-Oxley Act of 2002, the principal executive and financial officers are required to certify, among other things, that: (1) they reviewed annual and quarterly reports; (2) based upon their knowledge, the report does not omit or misstate a material fact; and (3) they had disclosed any fraud, whether or not material, involving management to the audit committee and the auditors.

13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and 21C of the Exchange Act, Respondent Stadler cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-11, and 13a-13, 13a-14, 13b2-1, and 13b2-2 thereunder.

B. Pursuant to Section 21C(f) of the Exchange Act and Section 8A(f) of the Securities Act, Respondent is prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

C. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $100,000 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 make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (2) 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 John A. Stadler 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 Ian S. Karpel, Assistant Regional Director, Division of Enforcement, Denver Regional Office, U.S. Securities and Exchange Commission, 1801 California St., Denver, CO 80238.

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, 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.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71682 / March 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15781

In the Matter of George Foreman Enterprises, Inc., MacKay Life Sciences, Inc., Reinsurance Technologies, Ltd. (a/k/a Solution Technology International, Inc.), Tire International Environmental Solutions, Inc., WatchIt Technologies, Inc., Weststar Financial Services Corporation, and WorldSpace, 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]

1. George Foreman Enterprises, Inc. ("GFME") (CIK No. 1079786) is a Delaware corporation located in Wilkes-Barre, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GFME 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, 2011, which reported a net loss of $146,765 for the prior nine months. As of March 6, 2014, the common stock of GFME was quoted on OTC Link operated

[1]The short form of each issuer's name is also its stock symbol.

by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. MacKay Life Sciences, Inc. ("BZEC") (CIK No. 1007018) is a void Delaware corporation located in Wayne, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BZEC 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, 2010, which reported a net loss of $445,545 for the prior six months. As of March 6, 2014, the common stock of BZEC was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Reinsurance Technologies, Ltd. (a/k/a Solution Technology International, Inc.) ("RSRN") (CIK No. 1000285) is a void Delaware corporation located in Alexandria, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). RSRN 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 applicable to common shareholders of $1,172,626 for the prior nine months. As of March 6, 2014, the common stock of RSRN was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Tire International Environmental Solutions, Inc. ("TRIE") (CIK No. 1099332) is a Nevada corporation located in Moncks Corner, South Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TRIE 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 $690,792 for the prior nine months. As of March 6, 2014, the common stock of TRIE 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. WatchIt Technologies, Inc. ("WTCT") (CIK No. 904901) is a defaulted Nevada corporation located in Arden, North Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). WTCT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2008, which reported a net loss of $21,000 for the prior three months. As of March 6, 2014, the common stock of WTCT 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. Weststar Financial Services Corporation ("WFSC") (CIK No. 1106181) is a North Carolina corporation located in Asheville, North Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). WFSC 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 $18,656,736 for the prior nine months. As of March 6, 2014, the common stock of WFSC was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. WorldSpace, Inc. ("WRSPQ") (CIK No. 1315054) is a forfeited Delaware corporation located in Silver Spring, Maryland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). WRSPQ 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 $72,784,000 for the prior six months. On October 17, 2008, WRSPQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was converted to a Chapter 7 proceeding on June 12, 2012, and was still pending as of March 6, 2014. As of March 6, 2014, the common stock of WRSPQ was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 11, 2014

In the Matter of **George Foreman Enterprises, Inc.,** **MacKay Life Sciences, Inc.,** **Reinsurance Technologies, Ltd.** **(a/k/a Solution Technology International, Inc.),** **Tire International Environmental Solutions, Inc.,** **WatchIt Technologies, Inc.,** **Weststar Financial Services Corporation, and** **WorldSpace, 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 George Foreman Enterprises, Inc. because it has not filed any periodic reports since the period ended September 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of MacKay Life Sciences, Inc. because it has not filed any periodic reports since the period ended June 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Reinsurance Technologies, Ltd. (a/k/a Solution Technology International, Inc.) because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Tire International Environmental Solutions, Inc. because it has not filed any periodic reports since the period ended June 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of WatchIt Technologies, Inc. because it has not filed any periodic reports since the period ended March 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Weststar Financial Services Corporation 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 WorldSpace, Inc. because it has not filed any periodic reports since the period ended June 30, 2008.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on March 11, 2014, through 11:59 p.m. EDT on March 24, 2014.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71680 / March 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15780

In the Matter of **Newnan Coweta Bancshares, Inc.,** **Proper Power and Energy Inc.,** **uVuMobile, Inc.,** **WGNB Corp., and** **YouBlast Global, 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]

1. Newnan Coweta Bancshares, Inc. ("NWCB") (CIK No. 1157282) is a dissolved Georgia corporation located in Newnan, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NWCB 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 $5,400,000 for the prior nine months. As of March 6, 2014, the common stock of NWCB was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

[1]The short form of each issuer's name is also its stock symbol.

2. Proper Power and Energy Inc. ("PPWE") (CIK No. 1357939) is a forfeited Delaware corporation located in Tampa, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PPWE 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, 2011, which reported a net loss of $156,086 for the prior nine months. As of March 6, 2014, the common stock of PPWE was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. uVuMobile, Inc. ("UVUM") (CIK No. 1089525) is a void Delaware corporation located in Duluth, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). UVUM 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 $6,216,210 for the prior year. As of March 6, 2014, the common stock of UVUM 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. WGNB Corp. ("WGNB") (CIK No. 1115568) is a dissolved Georgia corporation located in Carrollton, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). WGNB 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 $54,937,562 for the prior nine months. As of March 6, 2014, the common stock of WGNB was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. YouBlast Global, Inc. ("YBLT") (CIK No. 1131166) is a void Delaware corporation located in Miami Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). YBLT 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 $4,003,489 for the prior nine months. As of March 6, 2014, the common stock of YBLT was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

6. As 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 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 11, 2014

In the Matter of **Newnan Coweta Bancshares, Inc.,** **Proper Power and Energy Inc.,** **uVuMobile, Inc.,** **WGNB Corp., and** **YouBlast Global, 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 Newnan Coweta Bancshares, 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 Proper Power and Energy Inc. because it has not filed any periodic reports since the period ended September 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of uVuMobile, Inc. 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 WGNB Corp. 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 YouBlast Global, 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. EDT on March 11, 2014, through 11:59 p.m. EDT on March 24, 2014.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71695 / March 12, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15785

In the Matter of

JEFFERIES LLC (formerly known as JEFFERIES & COMPANY, INC.),

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(4) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934 ("Exchange Act") against Jefferies LLC (formerly known as Jefferies & Company, Inc.) ("Jefferies" 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. Respondent admits to the facts contained in paragraphs 5 to 8[1] and the Commission's jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

[1] Respondent has entered into a Non-Prosecution Agreement with the United States Attorney's Office for the District of Connecticut, in which Respondent has admitted to certain facts relating to the misconduct by representatives on its mortgage-backed securities desk.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

Summary

1. Respondent failed reasonably to supervise Jesse C. Litvak ("Litvak") and certain other representatives on the Respondent's mortgage-backed securities ("MBS") desk with a view to preventing and detecting their violations of the federal securities laws during the time period from 2009 to 2011. Litvak was a managing director and senior trader of residential MBS ("RMBS"). Among Litvak's and the other representatives' job responsibilities during this time was to trade RMBS on a principal basis with counterparties. In doing so, Litvak and other representatives of Respondent would purchase RMBS from one customer and sell the same RMBS to another customer on the same day ("intra-day trades"). Litvak and others on the MBS desk would also purchase RMBS, hold them in inventory and sell them to another customer at a later date ("inventory trades"). From 2009 to 2011, Litvak and certain other representatives lied to, or otherwise misled, customers about the price at which Respondent had bought RMBS and consequently the amount of the firm's profit on the trades. This misconduct deceived customers about the price at which Respondent had recently acquired the RMBS. Respondent's implementation of its supervisory procedures relating to review of its MBS desk representatives' electronic communications with customers was inadequate to prevent and detect these misrepresentations to customers.

Respondent

2. Respondent is a Delaware limited liability company with its primary office in New York, New York. Respondent has been registered with the Commission as a broker-dealer since 1969. Respondent is a member of the Financial Industry Regulatory Authority ("FINRA").

Other Relevant Person

3. Litvak, age 39, was associated with Respondent from approximately April 2008 to December 2011, when he was terminated in connection with the matters discussed herein. While he was associated with Respondent, Litvak worked in its Stamford, Connecticut office and was supervised by personnel in its Stamford office.

Prior Actions Against Litvak

4. On January 25, 2013, in the United States District Court for the District of Connecticut, Litvak was indicted and charged with securities fraud, fraud against the United States (specifically the Troubled Asset Relief Program), and making false statements to the United States government. On January 28, 2013, also in the United States District Court for the District of Connecticut, the Commission charged Litvak with violating Section 17(a) of the Securities Act of 1933 by engaging in fraud in the offer or sale of securities, and with violating Section 10(b) of the Exchange Act by engaging in fraud in connection with the purchase or sale of securities.

The Misconduct

5. From 2009 to 2011, Litvak engaged in misconduct on at least 25 RMBS trades. In each instance, Litvak made misrepresentations to, or otherwise misled, customers about the

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

price at which Respondent had purchased the RMBS before re-selling it to the customer and, consequently, about Respondent's trading profit.

6. Respondent's MBS desk executed intra-day and inventory trades with buyers and sellers of non-agency RMBS. The market for non-agency RMBS is opaque because there is no contemporaneous public dissemination of trade prices. Therefore, the buyer of a RMBS has no way to learn the price paid by the broker, unless the broker chooses to tell the customer. For intra-day trades, Respondent purchased RMBS from one customer and then sold the same security to another customer. Respondent's profits or losses in such intra-day trades were based on Respondent re-selling the RMBS and making or losing money based upon the spread (or difference) between the purchase price and the sale price. At times, when executing an intra-day trade, a representative from Respondent's MBS desk would negotiate the firm's profit spread. To negotiate that spread, a trader or sales person provided information to the customer about the purchase price and then the customer agreed to an amount "on top" of the purchase price the customer was willing to pay. Respondent's traders and their customers discussed the spread in terms of the number of "points" or "ticks" that Respondent would receive on a trade. One "tick" equals 1/32 of a point. For example, a price of 65-16, refers to 65 and 16 ticks or 65 16/32 (or 65.5). These negotiations often occurred in electronic communications, including Bloomberg group chats.

7. On at least 25 occasions, when Litvak resold RMBS in both intra-day and inventory trades, he lied to the customers about how much Respondent had paid for the securities. In order to negotiate a higher sale price to the customers, Litvak misled them into believing that Respondent had paid a higher price for the RMBS than it actually had. By misrepresenting the purchase price, Litvak misled customers about the amount of profit Respondent would receive on the transaction. For example, if Litvak told the customer that the purchase price was 80 and the sale price was 80 and 4 ticks, the customer understood that Respondent received 4 ticks in profit. However, if the purchase price was actually 79 and the sale price was 80 and 4 ticks, then Respondent received an extra undisclosed point in profit as a result of Litvak's misrepresentation. On some occasions, Litvak and the customer explicitly agreed on the amount of Respondent's profit based on the purchase price as represented by Litvak.

8. Some of Respondent's representatives on the MBS desk were aware of Litvak's misconduct. On a more limited basis, other representatives on Respondent's MBS desk also made misrepresentations to customers, similar to those made by Litvak, in connection with the negotiation of Respondent's trading profit. Litvak and the other representatives made these misrepresentations in electronic communications, including Bloomberg group chats.

Respondent's Failure to Supervise

9. Respondent failed reasonably to implement adequate procedures regarding its review of MBS traders' communications with their customers. During the relevant time period, the Respondent's policy regarding supervisory review of electronic communications provided that each employee's electronic communications were subject to review by a supervisor. Respondent used an automated system to select a sample of communications by each employee (on a daily basis) for review by his or her supervisor. The communications were selected both randomly and based on language-specific searches. The policy stated that the supervisor should review the selected communications "on a regular basis, preferably daily." The policy instructed

supervisors that "from time to time, the review of communications may require escalation to senior management and/or the Compliance Department," and provided a list of the types of communications that "should be escalated for further review," including communications containing an "[o]mission of material facts or presence of untrue, promissory, exaggerated or any other misleading statements."

10. Respondent failed reasonably to implement this procedure for review of communications in a manner that would reasonably be expected to detect the misrepresentations about purchase price made by Litvak and other representatives on Respondent's MBS desk. The market for RMBS is opaque because there is no public mechanism capturing bid and offer prices. Thus, because one of the compliance risks faced by a trading desk offering MBS is that representatives may make misrepresentations about pricing, Respondent needed to implement procedures reasonably designed to detect such misrepresentations in order to address the risks arising from its business. Respondent did not reasonably implement its procedures to guide supervisors on how to detect possible misrepresentations to customers in electronic correspondence which could then be elevated to management or compliance for further analysis.

11. In particular, although the firm's procedures required that supervisors review samples of all forms of electronic communications, during the relevant time period, Respondent's system for selecting electronic communications failed to include Bloomberg group chats. This systems failure caused certain types of communications with customers to be excluded from supervisory review. Included in these communications were misrepresentations made by Litvak and other representatives on the MBS desk to Respondent's customers about the price that Respondent paid for securities it was re-selling.

12. In addition, Respondent failed to provide direction and/or tools to supervisors to meaningfully review its representatives' communications with customers about the price that Respondent paid for the securities. A number of Litvak's (and the other representatives') electronic communications with customers contained direct misstatements about the price at which Respondent purchased the RMBS that were offered. Misrepresentations such as those made by Litvak and other representatives about RMBS pricing would have been difficult for supervisors to have detected without checking at least a sample of the representatives' communications about RMBS pricing against actual pricing information.

13. If Respondent had reasonably implemented its procedures to include Bloomberg group chats and to provide the necessary direction and/or tools in supervisory review of customer correspondence, the supervisors of Litvak and the other representatives who misrepresented price information to customers would likely have determined that Litvak's and the other Jeffries representatives' communications contained "untrue … exaggerated or [] other misleading statement[s]."

Conclusions

14. Under Section 15(b)(4)(E) of the Exchange Act, broker-dealers are responsible for reasonably supervising, with a view to preventing and detecting violations of the federal securities laws, persons subject to their supervision. Respondent was responsible for supervising Litvak and other representatives on the MBS desk.

15. Litvak engaged in conduct that violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Other representatives on Respondent's MBS desk engaged in conduct that violated Section 17(a)(2) of the Securities Act.

Respondent failed reasonably to supervise Litvak and the other representatives on Respondent's MBS desk for purposes of Section 15(b)(4)(E) of the Exchange Act because Respondent failed to implement its procedures regarding review of customer correspondence in a manner that would reasonably be expected to prevent and detect the violations by Litvak and the other representatives.

Respondent's Remedial Efforts and Cooperation

16. In determining to accept Respondent's Offer, the Commission considered the remedial acts undertaken by Respondent regarding its supervisory system, including, among other things, the implementation of targeted risk-based surveillance to supplement the previous procedures for reviewing electronic communications. According to Respondent, this surveillance includes sampling trades with specified pricing profiles and reviewing the relevant trade data against the related electronic communications with the goal of identifying any potential misrepresentations or inappropriate dealings in those transactions. The Commission also considered Respondent's voluntary disclosures concerning this matter and the cooperation afforded the Commission staff in its investigation of this matter.

Undertakings

17. Respondent shall retain, within 30 days of the date of the issuance of this Order, the services of an Independent Compliance Consultant ("Consultant") not unacceptable to the staff of the Commission. The Consultant's compensation and expenses shall be borne exclusively by Respondent. Respondent shall require the Consultant to conduct a review of any and all policies and procedures deemed relevant by the Consultant to preventing and detecting fraud on the MBS desk (and any other fixed income desk the Consultant determines is susceptible to the same misconduct described in this Order) including, but not limited to, the policies and procedures relating to the supervisory review of employees' electronic communications.

18. At the end of the review, which in no event shall be more than four months after the date of the issuance of this Order, Respondent shall require the Consultant to submit an Initial Report to Respondent 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. Respondent may suggest an alternative procedure designed to achieve the same objective or purpose as that of the recommendation of the Consultant. The Consultant shall evaluate any alternative procedure proposed by Respondent. If, upon evaluating Respondent's proposal, the Consultant determines that the suggested alternative is reasonably designed to accomplish the same objective as the recommendations in question, then the Consultant may approve the suggested alternative and make the recommendations. However, Respondent shall abide by the Consultant's final recommendation. Respondent shall require the Consultant to inform Respondent of the Consultant's final determination concerning any alternative recommendation within 14 days after the conclusion of the discussion and evaluation by Respondent and Consultant.

19. Within five months after the date of issuance of this Order, Respondent shall, in writing, advise the Consultant and the Commission staff of the recommendations it is adopting.

20. Within six months after the date of issuance of this Order, Respondent shall require the Consultant to complete its review and submit a written final report to Commission staff. The Final Report shall describe the review made of Respondent's policies and procedures relating to preventing and detecting fraud in the fixed income desks as selected by the

Consultant; set forth the conclusions reached and the recommendations made by the Consultant, as well as any proposals made by Respondent; and describe how Respondent is implementing the Consultant's final recommendations.

21. Respondent shall take all necessary and appropriate steps to adopt and implement all recommendations contained in the Consultant's Final Report.

22. No later than three months after the date of the Consultant's Final Report, Respondent shall submit to Commission staff an affidavit setting forth the details of its efforts to implement the Consultant's recommendations as set forth in the Final Report and its compliance with same.

23. Respondent shall require the 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 Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, 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 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 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 Respondent, 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.

24. Respondent 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 Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Kevin M. Kelcourse, Assistant Director, 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, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549, no later than sixty days from the date of completion of the undertakings.

25. Payments: Respondent also undertakes to make payments to customers in the aggregate amount of approximately $11,000,000, representing the full amount of the profits that Respondent earned on affected intra-day trades, which satisfies the disgorgement and pre-judgment interest ordered below in Section IV.B ("Payments"). Within one year after the date of entry of this Order, Respondent shall submit to the Commission staff for its approval a final accounting and certification of the Payments made, which final accounting and certification shall be in a format to be provided by the Commission staff. The final accounting and certification shall include, but not be limited to, for each transaction: (i) total profit on the transaction; (ii) amount paid to the customer(s); (iii) the date of the payment(s); and (iv) the check number(s) or other identifier of money transferred. Respondent shall submit proof and supporting documentation of such Payments (whether in the form of fee credits, cancelled checks, or otherwise) in a form acceptable to the Commission staff and under a cover letter that identifies Jefferies as Respondent in these proceedings and the file number of these proceedings to Kevin Kelcourse, Assistant Regional Director, Boston Regional Office, Securities and Exchange

Commission, 33 Arch Street, Boston, MA 02110, or such other address the Commission staff may provide. Respondent shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.

26. For good cause shown and upon timely application by the Consultant or Respondent, the Commission's staff may extend any of the deadlines set forth in these undertakings.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 15(b)(4) of the Exchange Act, Respondent is hereby censured.

B. Respondent shall pay disgorgement of $4,200,402 and prejudgment interest of $292,515 to the Securities and Exchange Commission. The foregoing amounts shall be deemed satisfied by Respondent's payments directly to customers as described in paragraph 25 above.

C. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $4,200,402 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 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 Jefferies 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 Kevin Kelcourse, Assistant

Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110.

D. Respondent shall comply with the undertakings enumerated in paragraphs 17 to 24 above.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9558 / March 12, 2014

Administrative Proceeding File No. 3-15785

In the Matter of
JEFFERIES LLC, (formerly known as JEFFERIES & COMPANY, INC.)
Respondent.

ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 602(c)(3) DISQUALIFICATION PROVISION

I.

Jefferies LLC (formerly known as Jefferies & Company, Inc.) ("Jefferies") has submitted a letter, dated February 7, 2014, requesting a waiver of the Rule 602(c)(3) disqualification from relying on the exemption under Regulation E from registering securities of certain issuers under the Securities Act of 1933 (the "Securities Act") arising from Jefferies' settlement of Administrative Proceedings commenced by the Commission.

II.

On March 12, 2014, pursuant to Jefferies' Offer of Settlement, the Commission entered an Order Instituting Administrative Proceedings Pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions (the "Order") against Jefferies. In the Order, the Commission found that Jefferies failed reasonably to supervise Jesse C. Litvak and certain other representatives on Jefferies' mortgage-backed securities ("MBS") desk with a view to preventing and detecting their violations of the federal securities laws during the time period from 2009 to 2011. During this period, Litvak and certain other representatives lied to, or otherwise misled, customers about the price at which Jefferies had bought residential MBS and consequently the amount of the firm's profit on the trades. Jefferies' implementation of its supervisory procedures relating to review of its MBS desk representatives' electronic communications with customers was inadequate to prevent and detect these misrepresentations to customers.

III.

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if, among others, any investment adviser or underwriter of the securities to be offered is "subject to an order of the Commission entered pursuant to section 15(b) . . . of the Securities Exchange Act of 1934." 17 C.F.R. § 230.602(c)(3). Rule 602(e) of Regulation E under the Securities Act provides, however, that the disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied." 17 C.F.R. § 230.602(e).

IV.

Based upon the representations set forth in Jefferies' request, the Commission has determined that pursuant to Rule 602(e) under the Securities Act a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Order.

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provision of Rules 602(c)(3) under the Securities Act resulting from the entry of the Order is hereby granted.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-71699; File No. S7-03-14]

RIN 3235-AL48

Standards for Covered Clearing Agencies

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") proposes to amend Rule 17Ad-22 and add Rule 17Ab2-2 pursuant to Section 17A of the Securities Exchange Act of 1934 ("Exchange Act") and the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act"), adopted in Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). Among other things, the proposed rules would establish standards for the operation and governance of certain types of registered clearing agencies that meet the definition of a "covered clearing agency."

DATES: Submit comments on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-03-14 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the

instructions for submitting comments.

Paper comments:

- Send paper comments to Kevin M. O'Neill, Deputy Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090. All submissions should refer to File Number S7-03-14.

To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml).

Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, N.E., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Katherine Martin, Senior Special Counsel; Stephanie Park, Special Counsel; Mark Saltzburg, Special Counsel; Matthew Lee, Attorney-Adviser; and Abraham Jacob, Attorney-Adviser; Office of Clearance and Settlement, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-7010, at (202) 551-5710.

SUPPLEMENTARY INFORMATION: The Commission proposes to amend Rule 17Ad-22 to add new Rule 17Ad-22(e) to establish requirements for risk management, operations, and governance of registered clearing agencies that meet the definition of a "covered clearing agency." Covered clearing agencies would include registered clearing agencies that (i) have been designated as systemically important by the Financial Stability Oversight Council

("FSOC") and for which the Commission is the supervisory agency, pursuant to the Clearing Supervision Act ("designated clearing agencies"), (ii) provide central counterparty ("CCP") services for security-based swaps or are involved in activities the Commission determines to have a more complex risk profile, where in either case the Commodity Futures Trading Commission ("CFTC") is not the supervisory agency for such clearing agency as defined in Section 803(8) of the Clearing Supervision Act, or (iii) are otherwise determined to be covered clearing agencies by the Commission. The Commission also proposes to add new Rule 17Ad-22(f) to codify the Commission's statutory authority and new Rule 17Ab2-2 to establish procedures for making determinations regarding covered clearing agencies under proposed Rule 17Ad-22(e). The Commission also proposes to amend existing Rule 17Ad-22(d) to limit its application to clearing agencies other than covered clearing agencies and to revise existing Rule 17Ad-22(a) to add 15 new definitions. The Commission has begun, and intends to continue, consultation with the FSOC and the Board of Governors of the Federal Reserve System ("the Board") and has considered the relevant international standards as required by Section 805(a)(2)(A) of the Clearing Supervision Act.[1]

TABLE OF CONTENTS:

I. CURRENT REGULATORY FRAMEWORK FOR CLEARING AGENCIES

- A. Section 17A of the Exchange Act
- B. OTC Swaps Clearing and the Dodd-Frank Act
  - 1. Title VII of the Dodd-Frank Act
  - 2. Title VIII of the Dodd-Frank Act
- C. Rule 17Ad-22 Under the Exchange Act

[1] See Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions ("CPSS-IOSCO"), Principles for Financial Market Infrastructures (Apr. 16, 2012), available at http://www.bis.org/publ/cpss101a.pdf ("PFMI Report").

D. Relevant International Standards
II. DISCUSSION OF THE PROPOSED AMENDMENTS TO RULE 17AD-22 AND PROPOSED RULE 17AB2-2
A. Overview
1. Scope of Proposed Rule 17Ad-22(e)
2. Role of Written Policies and Procedures
3. Frequency of Review Required Under Certain Policies and Procedures
4. Anticipated Impact of Proposed Rule 17Ad-22(e)
5. General Request for Comments
B. Proposed Rule 17Ad-22(e)
1. Proposed Rule 17Ad-22(e)(1): Legal Risk
2. Proposed Rule 17Ad-22(e)(2): Governance
3. Proposed Rule 17Ad-22(e)(3): Framework for the Comprehensive Management of Risks
a. Policies and Procedures Requirements, Periodic Review, and Annual Board Approval
b. Recovery and Orderly Wind-Down Plans
c. Risk Management and Internal Audit
d. Request for Comments
4. Proposed Rules 17Ad-22(e)(4) through (7): Financial Risk Management
a. Overview of Financial Risks Faced by Clearing Agencies
b. Current Financial Risk Management Requirements for CCPs
c. Proposed Rule 17Ad-22(e)(4): Credit Risk
i. Prefunded Financial Resources
ii. Combined or Separately Maintained Clearing or Guaranty Funds
iii. Testing the Sufficiency of Financial Resources
iv. Annual Conforming Model Validation
d. Proposed Rule 17Ad-22(e)(5): Collateral
e. Proposed Rule 17Ad-22(e)(6): Margin
i. Active Management of Model Risk
ii. Collection of Margin
iii. Ninety-Nine Percent Confidence Level
iv. Price Data Source
v. Method for Measuring Credit Exposure
vi. Backtesting and Sensitivity Analysis
vii. Annual Conforming Model Validation

f. Proposed Rule 17Ad-22(e)(7): Liquidity Risk

i. Sufficient Liquid Resources

ii. Qualifying Liquid Resources

iii. Access to Account Services at a Federal Reserve Bank or Other Relevant Central Bank

iv. Liquidity Providers

v. Maintenance and Annual Testing of Liquidity Provider Procedures and Operational Capacity

vi. Testing the Sufficiency of Liquid Resources

vii. Annual Conforming Model Validation

viii. Address Liquidity Shortfalls and Seek to Avoid Unwinding Settlement

ix. Replenishment of Liquid Resources

x. Feasibility Analysis for "Cover Two"

g. Request for Comments

5. Proposed Rule 17Ad-22(e)(8): Settlement Finality

6. Proposed Rule 17Ad-22(e)(9): Money Settlements

7. Proposed Rule 17Ad-22(e)(10): Physical Delivery Risks

8. Proposed Rule 17Ad-22(e)(11): Central Securities Depositories

a. Controls to Safeguard the Rights of Securities Issuers and Holders and Prevent the Unauthorized Creation or Deletion of Securities

b. Periodic and At Least Daily Reconciliation of Securities Maintained

c. Protect Assets against Custody Risk

d. Request for Comments

9. Proposed Rule 17Ad-22(e)(12): Exchange-of-Value Settlement Systems

10. Proposed Rule 17Ad-22(e)(13): Participant-Default Rules and Procedures

a. Address Allocation of Credit Losses

b. Describe Replenishment of Financial Resources

c. Test Default Procedures Annually and Following Material Changes

d. Request for Comments

11. Proposed Rule 17Ad-22(e)(14): Segregation and Portability

12. Proposed Rule 17Ad-22(e)(15): General Business Risk

a. Determining Liquid Net Assets for Recovery and an Orderly Wind-Down

b. Requirements for Liquid Net Assets

c. Plan for Raising Additional Equity

d. Request for Comments

13. Proposed Rule 17Ad-22(e)(16): Custody and Investment Risks

14. Proposed Rule 17Ad-22(e)(17): Operational Risk Management

15. Proposed Rule 17Ad-22(e)(18): Access and Participation Requirements

16. Proposed Rule 17Ad-22(e)(19): Tiered Participation Agreements

17. Proposed Rule 17Ad-22(e)(20): Links

18. Proposed Rule 17Ad-22(e)(21): Efficiency and Effectiveness

19. Proposed Rule 17Ad-22(e)(22): Communication Procedures and Standards

20. Proposed Rule 17Ad-22(e)(23): Disclosure of Rules, Key Procedures, and Market Data

a. Comprehensive Public Disclosure

b. Updates to the Comprehensive Public Disclosure

c. Request for Comments

C. Proposed Rule 17Ab2-2

1. Determination that a Registered Clearing Agency is a Covered Clearing Agency

2. Determination that a Covered Clearing Agency Is Systemically Important in Multiple Jurisdictions

3. Determination that a Clearing Agency Has a More Complex Risk Profile

4. Request for Comments

D. Proposed Rule 17Ad-22(f)

E. Proposed Amendment to Rule 17Ad-22(d)

III. PAPERWORK REDUCTION ACT

A. Overview and Organization

B. Summary of Collection of Information and Proposed Use of Information for Proposed Rule 17Ad-22(e) and Proposed Rule 17Ab2-2

1. Proposed Rules 17Ad-22(e)(1) through (3): General Organization

a. Proposed Rule 17Ad-22(e)(1)

b. Proposed Rule 17Ad-22(e)(2)

c. Proposed Rule 17Ad-22(e)(3)

2. Proposed Rules 17Ad-22(e)(4) through (7): Financial Risk Management

a. Proposed Rule 17Ad-22(e)(4)

b. Proposed Rule 17Ad-22(e)(5)

c. Proposed Rule 17Ad-22(e)(6)

d. Proposed Rule 17Ad-22(e)(7)

3. Proposed Rules 17Ad-22(e)(8) through (10): Settlement

a. Proposed Rule 17Ad-22(e)(8)

b. Proposed Rule 17Ad-22(e)(9)

c. Proposed Rule 17Ad-22(e)(10)

4. Proposed Rules 17Ad-22(e)(11) through (12): CSDs and Exchange-of-Value Settlement Systems

a. Proposed Rule 17Ad-22(e)(11)

b. Proposed Rule 17Ad-22(e)(12)

5. Proposed Rules 17Ad-22(e)(13) through (14): Default Management

a. Proposed Rule 17Ad-22(e)(13)

b. Proposed Rule 17Ad-22(e)(14)

6. Proposed Rules 17Ad-22(e)(15) through (17): General Business and Operational Risk Management

a. Proposed Rule 17Ad-22(e)(15)

b. Proposed Rule 17Ad-22(e)(16)

c. Proposed Rule 17Ad-22(e)(17)

7. Proposed Rules 17Ad-22(e)(18) through (20): Access

a. Proposed Rule 17Ad-22(e)(18)

b. Proposed Rule 17Ad-22(e)(19)

c. Proposed Rule 17Ad-22(e)(20)

8. Proposed Rules 17Ad-22(e)(21) through (22): Efficiency

a. Proposed Rule 17Ad-22(e)(21)

b. Proposed Rule 17Ad-22(e)(22)

9. Proposed Rule 17Ad-22(e)(23): Disclosure

10. Proposed Rule 17Ab2-2

C. Respondents

D. Total Annual Reporting and Recordkeeping Burden for Proposed Rule 17Ad-22(e)

1. Proposed Rules 17Ad-22(e)(1) through (3): General Organization

a. Proposed Rule 17Ad-22(e)(1)

b. Proposed Rule 17Ad-22(e)(2)

c. Proposed Rule 17Ad-22(e)(3)

2. Proposed Rules 17Ad-22(e)(4) through (7): Financial Risk Management

a. Proposed Rule 17Ad-22(e)(4)

b. Proposed Rule 17Ad-22(e)(5)

c. Proposed Rule 17Ad-22(e)(6)

d. Proposed Rule 17Ad-22(e)(7)

3. Proposed Rules 17Ad-22(e)(8) through (10): Settlement

a. Proposed Rule 17Ad-22(e)(8)

b. Proposed Rule 17Ad-22(e)(9)

c. Proposed Rule 17Ad-22(e)(10)

4. Proposed Rules 17Ad-22(e)(11) through (12): CSDs and Exchange-of-Value Settlement Systems

a. Proposed Rule 17Ad-22(e)(11)

b. Proposed Rule 17Ad-22(e)(12)

5. Proposed Rules 17Ad-22(e)(13) through (14): Default Management

a. Proposed Rule 17Ad-22(e)(13)

b. Proposed Rule 17Ad-22(e)(14)

6. Proposed Rules 17Ad-22(e)(15) through (17): General Business and Operational Risk Management

a. Proposed Rule 17Ad-22(e)(15)

b. Proposed Rule 17Ad-22(e)(16)

c. Proposed Rule 17Ad-22(e)(17)

7. Proposed Rules 17Ad-22(e)(18) through (20): Access

a. Proposed Rule 17Ad-22(e)(18)

b. Proposed Rule 17Ad-22(e)(19)

c. Proposed Rule 17Ad-22(e)(20)

8. Proposed Rules 17Ad-22(e)(21) through (22): Efficiency

a. Proposed Rule 17Ad-22(e)(21)

b. Proposed Rule 17Ad-22(e)(22)

9. Proposed Rule 17Ad-22(e)(23): Disclosure

10. Total Burden for Proposed Rule 17Ad-22(e)

E. Total Annual Reporting and Recordkeeping Burden for Proposed Rule 17Ab2-2

F. Collection of Information is Mandatory

G. Confidentiality

H. Request for Comments

IV. ECONOMIC ANALYSIS

A. Introduction

B. Economic Baseline

1. Overview

2. Current Regulatory Framework for Clearing Agencies

a. Basel III Capital Requirements

b. Other Regulatory Efforts

3. Current Practices

a. General Organization

i. Legal Risk

ii. Governance

iii. Framework for the Comprehensive Management of Risks

b. Financial Risk Management

i. Credit Risk

ii. Collateral and Margin

iii. Liquidity Risk

c. Settlement

d. CSDs and Exchange-of-Value Settlement Systems

i. CSDs

ii. Exchange-of-Value Settlement Systems

e. Default Management

i. Participant-Default Rules and Procedures

ii. Segregation and Portability

f. General Business and Operational Risk Management

i. General Business Risk

ii. Custody and Investment Risks

iii. Operational Risk

g. Access

i. Access and Participation Requirements

ii. Tiered Participation Arrangements

iii. Links

h. Efficiency

i. Efficiency and Effectiveness

ii. Communication Procedures and Standards

i. Transparency

4. Determinations by the Commission

C. Consideration of Benefits, Costs, and the Effect on Competition, Efficiency, and Capital Formation

1. General Economic Considerations

a. Systemic Risk

b. Discretion

c. Market Integrity

d. Concentration

e. Qualifying CCP Status and Externalities on Clearing Members

2. Effect on Competition, Efficiency, and Capital Formation

a. Competition

b. Efficiency

c. Capital Formation

3. Effect of Proposed Amendments to Rule 17Ad-22 and Proposed Rule 17Ab2-2

a. Proposed Rule 17Ad-22(e)

i. Proposed Rule 17Ad-22(e)(1): Legal Risk

ii. Proposed Rule 17Ad-22(e)(2): Governance

iii. Proposed Rule 17Ad-22(e)(3): Comprehensive Framework for the Management of Risks

iv. Proposed Rules 17Ad-22(e)(4) through (7): Financial Risk Management

(1) Proposed Rule 17Ad-22(e)(4): Credit Risk

(2) Proposed Rule 17Ad-22(e)(5): Collateral

(3) Proposed Rule 17Ad-22(e)(6): Margin

(4) Proposed Rule 17Ad-22(e)(7): Liquidity Risk

(5) Testing and Validation of Risk Models

v. Proposed Rules 17Ad-22(e)(8) through (10): Settlement and Physical Delivery

vi. Proposed Rule 17Ad-22(e)(11): CSDs

vii. Proposed Rule 17Ad-22(e)(12): Exchange-of-Value Settlement Systems

viii. Proposed Rule 17Ad-22(e)(13): Participant-Default Rules and Procedures

ix. Proposed Rule 17Ad-22(e)(14): Segregation and Portability

x. Proposed Rule 17Ad-22(e)(15): General Business Risk

xi. Proposed Rule 17Ad-22(e)(16): Custody and Investment Risks

xii. Proposed Rule 17Ad-22(e)(17): Operational Risk Management

xiii. Proposed Rules 17Ad-22(e)(18) through (20): Membership Requirements, Tiered Participation, and Linkages

(1) Proposed Rule 17Ad-22(e)(18): Member Requirements

(2) Proposed Rule 17Ad-22(e)(19): Tiered Participation Arrangements

(3) Proposed Rule 17Ad-22(e)(20): Links

xiv. Proposed Rule 17Ad-22(e)(21): Efficiency and Effectiveness

xv. Proposed Rule 17Ad-22(e)(22): Communication Procedures and Standards

xvi. Proposed Rule 17Ad-22(e)(23): Disclosure of Rules, Key Procedures, and Market Data

b. Proposed Rule 17Ab2-2

c. Proposed Rule 17Ad-22(f)

d. Quantifiable Costs and Benefits

D. Request for Comments

V. REGULATORY FLEXIBILITY ACT CERTIFICATION

A. Registered Clearing Agencies

B. Certification

VI. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

VII. STATUTORY AUTHORITY AND TEXT OF AMENDED RULE 17AD-22 AND PROPOSED RULE 17AB2-2

I. Current Regulatory Framework for Clearing Agencies

A. Section 17A of the Exchange Act

When Congress added Section 17A to the Exchange Act as part of the Securities Acts Amendments of 1975, it directed the Commission to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions.[2] In Section 17A of the Exchange Act, Congress directed the Commission to have due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents.[3] The Commission's ability to achieve these goals and its supervision of securities clearance and settlement systems is based upon the regulation of clearing agencies registered with the Commission ("registered clearing agencies"). Clearing agencies are broadly defined

2 See 15 U.S.C. 78q-1; Report of the Senate Committee on Banking, Housing & Urban Affairs, S. Rep. No. 94-75, at 4 (1975) (urging that "[t]he Committee believes the banking and security industries must move quickly toward the establishment of a fully integrated national system for the prompt and accurate processing and settlement of securities transactions").

3 See 15 U.S.C. 78q-1(a)(2)(A).

under the Exchange Act and undertake a variety of functions.[4] One such function is to act as a CCP, which is an entity that interposes itself between the counterparties to a trade.[5] Over the years, registered clearing agencies have become an essential part of the infrastructure of the U.S. securities markets.[6] Registered clearing agencies help reduce the costs and increase the safety and efficiency of securities trading and are required to be structured to manage and reduce counterparty risk.[7]

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4 Section 3(a)(23)(A) of the Exchange Act defines the term "clearing agency" to mean any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for the comparison of data regarding the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned or pledged by bookkeeping entry without physical delivery of securities certificates, or otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates. See 15 U.S.C. 78c(a)(23)(A).

5 See id.; see also Exchange Act Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219, 66221–22 (Nov. 2, 2012) ("Clearing Agency Standards Release"). An entity that acts as a CCP for securities transactions is a clearing agency as defined in the Exchange Act and is required to register with the Commission. For further discussion of the economic effects of CCPs, see infra notes 19, 563, and accompanying text.

6 See Risk Management Supervision of Designated Clearing Entities (July 2011), Report by the Commission, the Board & CFTC to the Senate Committees on Banking, Housing & Urban Affairs and Agriculture in fulfillment of Section 813 of Title VIII of the Dodd-Frank Act, at 3 (stating that designated clearing entities "play a vital role in the proper functioning of financial markets and are increasingly important given the mandated central clearing of certain swaps and security-based swaps that is required by the [Dodd-Frank] Act") ("Risk Management Supervision Report").

7 See id. at 12 (describing the risk management practices of designated clearing entities and the economic and legal incentives for sound risk management).

Section 17A of the Exchange Act and Rule 17Ab2-1 require entities to register with the Commission prior to performing the functions of a clearing agency.[8] Under the statute, the Commission is not permitted to grant registration unless it determines that the rules and operations of the clearing agency meet the standards set forth in Section 17A of the Exchange Act.[9] If the Commission registers a clearing agency, the Commission oversees the clearing agency to facilitate compliance with the Exchange Act using various tools that include, among other things, the rule filing process for self-regulatory organizations ("SROs") and on-site examinations by Commission staff.[10] The Commission also oversees registered clearing agencies through regular contact, including onsite visits, by Commission staff with clearing agency senior management and other personnel and ongoing interactions of Commission staff with the registered clearing agencies regarding current and expected proposed rule changes under Section 19(b) of the Exchange Act.

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8 See 15 U.S.C. 78q-1(b) and 17 CFR 240.17Ab2-1 thereunder; see also infra notes 20–23 and accompanying text (noting that the Dodd-Frank Act also added new paragraphs (g), (i), and (j) to Section 17A of the Exchange Act to establish requirements for any entity that performs the functions of a clearing agency for security-based swaps).

9 A clearing agency can be registered with the Commission only if the Commission makes a determination that the clearing agency satisfies the requirements set forth in Section 17A(b)(3)(A) through (I) of the Exchange Act. See 15 U.S.C. 78q-1(b)(3)(A) through (I). In 1980, the Commission published a statement of the views and positions of the Commission staff regarding the requirements of Section 17A in its Announcement of Standards for the Registration of Clearing Agencies. See Exchange Act Release No. 34-16900 (June 17, 1980), 45 FR 41920 (June 23, 1980).

10 Under the Clearing Supervision Act, the supervisory agency must consult annually with the Board regarding the scope and methodology of on-site examinations of designated FMUs, and those examinations may include participation by the Board, if requested. See infra note 32 and accompanying text; see also 15 U.S.C. 78u(a) (providing the Commission with authority to initiate and conduct investigations to identify potential violations of the federal securities laws); 15 U.S.C. 78s(h) (providing the Commission with authority to institute civil actions seeking injunctive and other equitable remedies and/or administrative proceedings).

B. OTC Swaps Clearing and the Dodd-Frank Act

The Commission drew on its experience regulating clearing agencies to address recent developments in the over-the-counter ("OTC") derivatives markets. In December 2008, the Commission acted to facilitate the central clearing of credit default swaps ("CDS") by permitting certain entities that performed CCP services to clear and settle CDS on a temporary, conditional basis.[11] Consequently, some CDS transactions were centrally cleared prior to the enactment of the Dodd-Frank Act.

On July 21, 2010, President Barack Obama signed the Dodd-Frank Act into law.[12] The Dodd-Frank Act was enacted, among other reasons, to promote the financial stability of the United States by improving accountability and transparency in the financial system.[13] It is intended, among other things, to bolster the existing regulatory structure and provide regulatory

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11 The Commission authorized five entities to clear CDS. See Exchange Act Release Nos. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009), 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) and 63389 (Nov. 29, 2010), 75 FR 75520 (Dec. 3, 2010) (CDS clearing by ICE Clear Europe Limited); 60373 (July 23, 2009), 74 FR 37740 (July 29, 2009), 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010) and 63390 (Nov. 29, 2010), 75 FR 75518 (Dec. 3, 2010) (CDS clearing by Eurex Clearing AG); 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) and 63388 (Nov. 29, 2010), 75 FR 75522 (Dec. 3, 2010) (CDS clearing by Chicago Mercantile Exchange, Inc.); 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009), 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) and 63387 (Nov. 29, 2010), 75 FR 75502 (Dec. 3, 2010) (CDS clearing by ICE Trust US LLC); 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) (collectively "CDS clearing exemption orders"). LIFFE A&M and LCH.Clearnet Ltd. allowed their orders to lapse without seeking renewal.

12 See Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

13 See id.

tools to address risks in the OTC derivatives markets, which have experienced dramatic growth in recent years and are capable of affecting significant sectors of the U.S. economy.[14]

1. Title VII of the Dodd-Frank Act

Title VII of the Dodd-Frank Act ("Title VII") provides the Commission and the CFTC with enhanced authority to regulate certain OTC derivatives in response to the 2008 financial crisis.[15] Title VII provides that the CFTC will regulate "swaps," the Commission will regulate "security-based swaps," and both the CFTC and the Commission will regulate "mixed swaps."[16] Title VII provides the Commission with new regulatory authority over security-based swaps by requiring, among other things, that security-based swaps generally be cleared and that clearing agencies for security-based swaps register with the Commission.

The swap and security-based swap markets traditionally have been characterized by privately negotiated transactions entered into by two counterparties, in which each assumes the

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14 From their beginnings in the early 1980s, the notional value of these markets grew to approximately $693 trillion globally by June 2013. See Bank for International Settlements ("BIS"), Statistical Release: OTC Derivatives Statistics at End-June 2013, at 2 (Nov. 2013), available at http://www.bis.org/publ/otc_hy1311.pdf.

15 See Dodd-Frank Act, 124 Stat. at 1641–1802.

16 Section 712(d) of the Dodd-Frank Act provides that the Commission and the CFTC, in consultation with the Board, shall further define the terms "swap," "security-based swap," "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," "eligible contract participant," and "security-based swap agreement." 124 Stat. at 1644. The Commission and the CFTC jointly adopted rules to further define the terms "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," and "eligible contract participant," as well as rules to further define the terms "swap," "security-based swap," and "security-based swap agreement" and to govern the regulation of mixed swaps. See Exchange Act Release Nos. 34-67453 (July 18, 2012), 77 FR 48208 (Aug. 13, 2012); 34-66868 (Apr. 27, 2012), 77 FR 30596 (May 23, 2012).

credit risk of the other counterparty.[17] Title VII amended the Exchange Act to require that transactions in security-based swaps be cleared through a clearing agency if they are of a type that the Commission determines must be cleared, unless an exemption from mandatory clearing applies.[18] When structured and operated appropriately, clearing agencies may improve the management of counterparty risk in security-based swap markets and may provide additional benefits, such as the multilateral netting of trades.[19]

Title VII also added new provisions to the Exchange Act that require entities performing the functions of a clearing agency with respect to security-based swaps ("security-based swap clearing agencies") to register with the Commission and require the Commission to adopt rules with respect to security-based swap clearing agencies.[20] Specifically, new Section 17A(j)

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17 See, e.g., Exchange Act Release No. 34-60372 (July 23, 2009), 74 FR 37748 (July 29, 2009), at 37748 n.2 (discussing credit default swaps).

18 See 15 U.S.C. 78c-3; see also Exchange Act Release No. 34-67286 (June 28, 2012), 77 FR 41602 (July 13, 2012) (adopting rules establishing a process for submissions for review of security-based swaps for mandatory clearing); Exchange Act Release No. 34-63556 (Dec. 15, 2010), 75 FR 79992 (Dec. 21, 2010) (proposing an end-user exception to the mandatory clearing requirement).

19 See Stephen G. Cecchetti, Jacob Gyntelberg & Marc Hollanders, Central Counterparties for Over-the-Counter Derivatives, BIS Q. Rev., Sept. 2009, at 46, available at http://www.bis.org/publ/qtrpdf/r_qt0909f.pdf (stating that the structure of a CCP "has three clear benefits. First, it improves the management of counterparty risk. Second, it allows the CCP to perform multilateral netting of exposures as well as payments. Third, it increases transparency by making information on market activity and exposures – both prices and quantities – available to regulators and the public") (emphasis omitted); see also Exchange Act Release No. 34-60372, supra note 17, at 37749 (discussing the benefits of using well-regulated CCPs to clear transactions in credit default swaps). But see infra note 563 and accompanying text (discussing the limits of clearing through central counterparties).

20 See 15 U.S.C. 78q-1(g); Dodd-Frank Act, Sec. 763(b), Pub. L. No. 111-203, 124 Stat. 1376, 1768 (2010) (adding paragraph (g) to Section 17A of the Exchange Act). Pursuant to Section 774 of the Dodd-Frank Act, the requirement in Section 17A(g) of the Exchange Act for security-based swap clearing agencies to be registered with the Commission took effect on July 16, 2011. See 124 Stat. at 1802.

requires the Commission to adopt rules governing security-based swap clearing agencies, and new Section 17A(i) gives the Commission authority to promulgate rules that establish standards for security-based swap clearing agencies.[21] Compliance with any such rules is a prerequisite to the registration of a clearing agency that clears security-based swaps with the Commission and is also a condition to maintain its continued registration.[22] Section 17A(i) also provides that the Commission, in establishing clearing agency standards and in its oversight of clearing agencies, may conform such standards and such oversight to reflect evolving international standards.[23] Before commencing any rulemaking regarding, among other things, security-based swap clearing agencies, Title VII provides that the Commission shall consult and coordinate, to the extent possible, with the CFTC and the prudential regulators for the purpose of assuring regulatory consistency and comparability, to the extent possible.[24]

Title VII further provides that some of the entities that the Commission permitted to clear and settle CDS on a temporary, conditional basis prior to the July 21, 2010 enactment of the Dodd-Frank Act are deemed under the Dodd-Frank Act to be registered clearing agencies (the "deemed registered provision").[25] As a result, the Chicago Mercantile Exchange, Inc. ("CME"),

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21 See 15 U.S.C. 78q-1(i), (j); Dodd-Frank Act, Sec. 763(b), 124 Stat. at 1768–69 (adding paragraphs (i) and (j) to Section 17A of the Exchange Act).

22 See supra note 9 (describing the requirements under Section 17A(b)(3) of the Exchange Act, 15 U.S.C. 78q-1(b)(3)).

23 See 15 U.S.C. 78q-1(i) (stating that, in establishing standards for security-based swap clearing agencies, and in the exercise of its oversight of such a clearing agency pursuant to this title, the Commission may conform such standards or oversight to reflect evolving United States and international standards).

24 See Dodd-Frank Act, Sec. 712(a)(2), 124 Stat. at 1641–42.

25 See 15 U.S.C. 78q-1(l). The deemed registered provision applies to certain depository institutions that cleared swaps as multilateral clearing organizations and certain derivatives

ICE Clear Credit LLC ("ICE"), and ICE Clear Europe LLC ("ICEEU") became clearing agencies deemed registered with the Commission on July 16, 2011, solely for the purpose of clearing security-based swaps.

2. Title VIII of the Dodd-Frank Act

The Clearing Supervision Act, adopted in Title VIII of the Dodd-Frank Act ("Title VIII"), provides for enhanced regulation of financial market utilities ("FMUs"), such as clearing agencies that manage or operate a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the FMU.[26] The enhanced regulatory regime in Title VIII applies only to FMUs that the FSOC designates as systemically important (or likely to become systemically important) in accordance with Section 804 of the Clearing Supervision Act.[27] On

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clearing organizations ("DCOs") that cleared swaps pursuant to an exemption from registration as a clearing agency before the date of enactment of the Dodd-Frank Act. Under the deemed registered provision, such a clearing agency is deemed registered for the purpose of clearing security-based swaps and is therefore required to comply with all requirements of the Exchange Act, and the rules thereunder, applicable to registered clearing agencies, including, for example, the obligation to file proposed rule changes under Section 19(b) of the Exchange Act. See infra note 96 (describing the requirements in Section 19(b) of the Exchange Act).

26 The definition of "financial market utility" in Section 803(6) of the Clearing Supervision Act contains a number of exclusions that include, but are not limited to, certain designated contract markets, registered futures associations, swap data repositories, swap execution facilities, national securities exchanges, national securities associations, alternative trading systems, security-based swap data repositories, security-based swap execution facilities, brokers, dealers, transfer agents, investment companies and futures commission merchants. See 12 U.S.C. 5462(6)(B).

27 Pursuant to Section 803(9) of the Clearing Supervision Act, an FMU is systemically important if the failure of or a disruption to the functioning of such FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. See 12 U.S.C. 5462(9).

July 11, 2011, the FSOC published a final rule concerning its authority to designate FMUs as systemically important.[28]

Section 806(e) of the Clearing Supervision Act requires FMUs designated as systemically important to file 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 FMU ("Advance Notice").[29] In addition, Section 806(e) requires each supervisory agency to adopt rules, in consultation with the Board, that define and describe when a designated FMU is required to file an Advance Notice with its supervisory agency.[30] The Commission published a final rule concerning the Advance Notice process for designated clearing agencies on June 28, 2012.[31] In evaluating an

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28 See 76 FR 44763 (July 27, 2011). Under Section 804 of the Clearing Supervision Act, the FSOC has the authority, on a non-delegable basis and by a vote of no fewer than two-thirds of the members then serving, including the affirmative vote of its chairperson, to designate those FMUs that the FSOC determines are, or are likely to become, systemically important. See 12 U.S.C. 5463. The FSOC may, using the same procedures as discussed above, rescind such designation if it determines that the FMU no longer meets the standards for systemic importance. Before making either determination, the FSOC is required to consult with the Board and the relevant supervisory agency (as determined in accordance with Section 803(8) of the Clearing Supervision Act). See id. Finally, Section 804 of the Clearing Supervision Act sets forth the procedures for giving entities a 30-day notice and the opportunity for a hearing prior to a designation or rescission of the designation of systemic importance. See id.

29 See 12 U.S.C. 5465(e)(1)(A).

30 Section 803(8) of the Clearing Supervision Act defines the term "supervisory agency" in reference to the primary regulatory authority for the FMU. For example, it provides that the Commission is the supervisory agency for any FMU that is a registered clearing agency. See 12 U.S.C. 5462(8). To the extent that an entity is both a clearing agency registered with the Commission and registered with another agency, such as a DCO registered with the CFTC, the statute requires the two agencies to agree on one agency to act as the supervisory agency, and if the agencies cannot agree on which agency has primary jurisdiction, the FSOC shall decide which agency is the supervisory agency for purposes of the Clearing Supervision Act. See 12 U.S.C. 5462(8).

31 See Exchange Act Release No. 34-67286 (June 28, 2012), 77 FR 41602 (July 13, 2012).

Advance Notice filed with the Commission, the Commission would assess, among other things, the consistency of the Advance Notice with the rules proposed herein, if adopted.

The Clearing Supervision Act also provides for enhanced coordination between the Commission, the Board, and the CFTC by facilitating examinations and information sharing. Under Section 807 of the Clearing Supervision Act, the Commission and the CFTC must consult annually with the Board regarding the scope and methodology of any examination of a designated FMU, and the Board is authorized to participate in any such examination.[32] Section 809 of the Clearing Supervision Act authorizes the Commission, the Board, and the CFTC to disclose to each other copies of examination reports or similar reports regarding any designated FMU.[33] It further authorizes the Commission, the Board, and the CFTC to promptly notify each other of material concerns about a designated FMU and share appropriate reports, information, or data relating to such concerns.[34] Section 813 of the Clearing Supervision Act requires the Commission and the CFTC to coordinate with the Board to develop risk management supervision programs for designated clearing agencies.[35]

Section 805(a) of the Clearing Supervision Act[36] also provides that the Commission may prescribe risk management standards governing the operations related to payment, clearing, and settlement activities ("PCS activities") of designated FMUs for which it acts as the supervisory

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32 See 12 U.S.C. 5466.

33 See 12 U.S.C. 5468.

34 See id.

35 See 12 U.S.C. 5472; see also Risk Management Supervision Report, supra note 6.

36 12 U.S.C. 5464(a).

agency, in consultation with the FSOC and the Board and taking into consideration relevant international standards and existing prudential requirements.[37]

On July 18, 2012, the FSOC designated as systemically important the following registered clearing agencies: CME, The Depository Trust Company ("DTC"), Fixed Income Clearing Corporation ("FICC"), ICE, National Securities Clearing Corporation ("NSCC"), and The Options Clearing Corporation ("OCC").[38] Under the Clearing Supervision Act, the Commission is the supervisory agency for DTC, FICC, NSCC, and OCC.[39] The Commission jointly regulates DTC with the Board and OCC with the CFTC.[40] The Commission also jointly regulates CME and ICE with the CFTC, which serves as their supervisory agency.[41]

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37 See 12 U.S.C. 5464(a)(2) (stating that these regulations may govern the operations related to payment, clearing, and settlement activities of such designated clearing entities, and the conduct of designated activities by such financial institutions). PCS activities are defined in Section 803(7) of the Clearing Supervision Act. See 12 U.S.C 5462(7).

38 See U.S. Treasury Dep't, Financial Stability Oversight Council Makes First Designations in Effort to Protect Against Future Financial Crises (July 18, 2012), http://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx; see also 12 U.S.C. 5321 (establishing the FSOC and designating its voting and non-voting members); 12 U.S.C. 5463 (describing the designation of systemic importance by the FSOC); supra note 28 (describing the process by which the FSOC would make or rescind a designation of systemic importance). Section 804 of the Clearing Supervision Act, 12 U.S.C. 5463, further sets forth procedures that give entities 30 days advance notice and an opportunity for a hearing prior to being designated as systemically important. See FSOC, 2012 Annual Report, at app. A, available at http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf.

39 See supra note 30 (discussing designation as the supervisory agency); see also FSOC, 2013 Annual Report, at 99–101, 113 (further discussing the same), available at http://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf.

40 As a member of the U.S. Federal Reserve System and a limited purpose trust company under New York State banking law, DTC is subject to regulation by the Board.

41 In addition, the Commission jointly regulates ICEEU, which is not currently designated as systemically important by the FSOC, with the CFTC and the Bank of England.

C. Rule 17Ad-22 Under the Exchange Act

On October 22, 2012, the Commission adopted Rule 17Ad-22 under the Exchange Act.[42] Through Rule 17Ad-22, the Commission sought to strengthen the substantive regulation of registered clearing agencies, promote the safe and reliable operation of registered clearing agencies, and improve efficiency, transparency, and access to registered clearing agencies by establishing minimum requirements with due consideration given to observed practices and international standards.[43] At that time, the Commission noted that the implementation of Rule 17Ad-22 would be an important first step in developing the regulatory changes contemplated by Titles VII and VIII of the Dodd-Frank Act.[44] Rule 17Ad-22 requires all registered clearing agencies to establish, implement, maintain and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.[45] These requirements are designed to work in tandem with the SRO rule filing process and the requirement in Section 17A of the Exchange Act that the Commission must make certain determinations regarding a clearing agency's rules

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42 See Clearing Agency Standards Release, supra note 5.

43 See id. at 66225, 66263–64.

44 See Clearing Agency Standards Release, supra note 5, at 66225.

45 Rules 17Ad-22(b)(1) through (4) contain several requirements that address risk management practices by registered clearing agencies that provide CCP services. Rules 17Ad-22(b)(5) through (7) establish certain requirements regarding access to registered clearing agencies that provide CCP services. Rule 17Ad-22(c) requires that a registered clearing agency providing CCP services calculate and maintain a record of its financial resources and requires each registered clearing agency to publish annual audited financial statements. Rule 17Ad-22(d) sets forth certain minimum standards for the operations of registered clearing agencies providing CCP or central securities depository ("CSD") services. See infra Part II.B.4.b (discussing the current requirements for CCPs under Rule 17Ad-22); see also Clearing Agency Standards Release, supra note 5 (adopting the existing standards under Rule 17Ad-22).

and operations for purposes of initial and ongoing registration.[46] Rule 17Ad-22 does not apply to entities that are operating pursuant to an exemption from registration as a clearing agency granted by the Commission,[47] and it does not give particular consideration to issues relevant to clearing agencies designated as systemically important FMUs.

D. Relevant International Standards

In proposing amendments to Rule 17Ad-22, the Commission considered international standards, as required by Section 805(a) of the Clearing Supervision Act, that are relevant to its supervision of covered clearing agencies.[48] CPSS-IOSCO published in April 2012 the PFMI

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46 See supra note 9 (describing the requirements under Section 17A(b)(3) of the Exchange Act, 15 U.S.C. 78q-1(b)(3)) and infra note 96 (further describing the Commission's framework for regulation of SROs and the SRO rule filing process).

47 See, e.g., Exchange Act Release No. 34-44188 (Apr. 17, 2001), 66 FR 20494 (Apr. 23, 2011) (the Omgeo exemption); Exchange Act Release No. 34-39643 (Feb. 11, 1998), 63 FR 8232 (Feb. 18, 1998) (the Euroclear exemption); Exchange Act Release No 34-38328 (Feb. 24, 1997), 62 FR 9225 (Feb. 28, 1997) (the Clearstream exemption).

48 See supra note 36. In addition, the Basel Committee on Banking Supervision ("BCBS"), the international body that sets standards for the regulation of banks, published in July 2012 the Capital Requirements for Bank Exposures to Central Counterparties ("Basel III capital requirements"). The Basel III capital requirements set forth interim rules governing the capital charges arising from bank exposures to CCPs related to OTC derivatives, exchange-traded derivatives, and securities financing transactions (which term, as used throughout this release, refers generally to repurchase agreements and securities lending). Among other things, the Basel III framework imposes lower capital requirements on CCPs that obtain "qualifying CCP" ("QCCP") status and would apply QCCP status only to CCPs that are subject to a regulatory framework consistent with the standards set forth in the PFMI Report. See BCBS, Capital Requirements for Bank Exposures to Central Counterparties (July 2012), available at http://www.bis.org/publ/bcbs227.pdf (setting forth he interim requirements set forth in this report, currently under revision by the BCBS, in consultation with CPSS and IOSCO). See also BCBS, Capital Treatment of Bank Exposures to Central Counterparties: Consultative Document (rev. July 2013), available at http://www.bis.org/publ/bcbs253.pdf; BIS, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (rev. June 2011), available at http://www.bis.org/publ/bcbs189.htm ("Basel III framework"). The Basel III capital requirements are one component of the Basel III framework.

Report[49] to replace previous standards applicable to clearing agencies contained in two earlier reports: Recommendations for Securities Settlement Systems (2001) ("RSSS") and Recommendations for Central Counterparties (2004) ("RCCP") (collectively "CPSS-IOSCO Recommendations").[50] Commission staff participated in the development and drafting of the

49 See supra note 1.

The PFMI Report defines a "financial market infrastructure" ("FMI") as a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions. See id. at 7; FMIs include CCPs, CSDs, securities settlement systems ("SSSs"), and trade repositories ("TRs"). Cf. 12 U.S.C. 5462(6)(B), supra note 30 (defining "financial market utility" under the Clearing Supervision Act).

The PFMI Report presumes that all CSDs, SSSs, CCPs, and TRs are systemically important in their home jurisdiction. See PFMI Report, supra note 1, at 131 & n.177 (noting the "presumption . . . that all CSDs, SSSs, CCPs, and TRs are systemically important because of their critical roles in the markets they serve," but also noting that ultimately "national law will dictate the criteria to determine whether an FMI is systemically important").

The Commission notes that the PFMI Report's definition of "financial market infrastructure" is consistent with the Commission's prior use of the term. See Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92d Cong., 1st Sess. 13 (1971) (defining "financial market infrastructure" as a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions).

50 The CPSS-IOSCO Recommendations are available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD123.pdf and http://www.iosco.org/library/pubdocs/pdf/IOSCPD176.pdf.

The Board applies these standards in its supervisory process and expects systemically important FMUs, as determined by the Board and subject to its authority, to complete a self-assessment against the standards set forth in the policy. See Financial Market Utilities, 77 FR 45907 (Aug. 2, 2012) (the Board adopting Regulation HH for FMUs) ("Reg. HH"); Policy on Payments System Risk, 72 FR 2518 (Jan. 12, 2007).

The Board has proposed to amend the standards in Regulation HH to replace the current standards for payment systems with standards based those set forth in the PFMI Report. It has also proposed to amend its Policy on Payments System Risk. See infra note 53.

PFMI Report,[51] and the Commission believes that the standards set forth in the PFMI Report are generally consistent with the requirements applicable to clearing agencies set forth in the Exchange Act.[52] Regulatory authorities around the world are in various stages of updating their regulatory regimes to adopt measures that are in line with the standards set forth in the PFMI Report.[53] The rule proposals set forth below are a continuation of the Commission's active efforts to foster the development of the national clearance and settlement system.

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51 Commission staff co-chaired the Editorial Team, a working group within CPSS-IOSCO that drafted both the consultative and final versions of the PFMI Report.

52 See 15 U.S.C. 78q-1; 15 U.S.C. 78s(b).

53 See CPSS-IOSCO, Implementation Monitoring of PFMIs – Level 1 Assessment Report (Aug. 2013), available at http://www.bis.org/publ/cpss111.pdf (describing efforts by various jurisdictions to adopt standards for FMIs in line with the PFMI Report) ("PFMI Implementation Monitoring Report"); see also Reg. HH, supra note 50; Financial Market Utilities, 79 FR 3665 (Jan. 22, 2014) (the Board proposing to amend Reg. HH) ("proposed Reg. HH"); Policy on Payment System Risk, 79 FR 2838 (Jan. 16, 2014) (the Board proposing to amend its Federal Reserve Policy on Payments System Risk) ("proposed PSR Policy"); Derivatives Clearing Organizations and International Standards, 78 FR 72475 (Dec. 2, 2013) (CFTC adopting rules for DCOs in line with international standards) ("DCO Int'l Standards Release"); Enhanced Risk Management Standards for Systemically Important Derivatives Clearing Organizations, 78 FR 49663 (Aug. 15, 2013) (CFTC adopting rules for systemically important DCOs) ("SIDCO Release"); Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334 (Nov. 8, 2011) (CFTC adopting rules for DCOs); ("DCO Principles Release").

In addition, the Board and the Office of the Comptroller of the Currency have adopted rules implementing the material elements of the BCBS interim framework for capitalization of bank exposures to CCPs. See Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 76 FR 62017, 62099 (Oct. 11, 2013) ("Regulatory Capital Rules"). The Board also noted the ongoing international discussions on this topic and stated that it intends to revisit its rules once the Basel III capital framework is revised. See id. The Board and the Office of the Comptroller of the Currency's final rules define "QCCP" to mean, among other things, a designated FMU under the Clearing Supervision Act. See 12 CFR 217.2; see also Regulatory Capital Rules, supra, at 62100.

II. Discussion of the Proposed Amendments to Rule 17Ad-22 and Proposed Rule 17Ab2-2

The Commission is proposing to amend Rule 17Ad-22 and add Rule 17Ab2-2 pursuant to Section 17A of the Exchange Act and the Clearing Supervision Act to provide a new regulatory framework for "covered clearing agencies," as defined below.

Generally, Section 17A directs the Commission to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and the maintenance of fair competition among brokers and dealers.[54] It further requires that a clearing agency be so organized and have the capacity and rules designed to, among other things, facilitate the prompt and accurate clearance and settlement of securities transactions, and to comply with the provisions of the Exchange Act and the rules and regulations thereunder.[55] In establishing a regulatory framework for clearance and settlement, the Exchange Act requires that a registered clearing agency's rules not impose any burden on competition not necessary or appropriate in the furtherance of the purposes of the Exchange Act.[56]

Consistent with these statutory objectives, the Commission previously adopted Rule 17Ad-22(d) to establish minimum requirements for registered clearing agencies and indicated that it might consider further rulemaking at a later date.[57] In furtherance of the provisions of Section 17A of the Exchange Act and the Clearing Supervision Act described above and as

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54 See 15 U.S.C. 78q-1(a)(2)(A).

55 See 15 U.S.C. 78q-1(a)(3)(A), (F).

56 See 15 U.S.C. 78q-1(b)(3)(I).

57 See Clearing Agency Standards Release, supra note 5, at 66224–25.

previously considered by the Commission, the Commission is proposing Rule 17Ad-22(e) to establish new requirements for covered clearing agencies, which the Commission preliminarily believes are appropriate given the risks that their size, operation, and importance pose to the U.S. securities markets, the risks inherent in the products they clear, and the goals of Title VII and the Exchange Act.[58] In connection with its supervision of registered clearing agencies under Section 17A of the Exchange Act, including after the adoption of Rule 17Ad-22,[59] the Commission has considered whether enhanced requirements for covered clearing agencies could contribute to the stability of U.S. securities markets, as described further in Part IV, and has determined to issue this proposal for comment.

The Commission has preliminarily chosen to retain Rule 17Ad-22(d) and to continue to apply it to registered clearing agencies that are not covered clearing agencies.[60] The Commission preliminarily believes that retaining Rule 17Ad-22(d) ensures that clear, comprehensive, and transparent standards for registered clearing agencies that are not covered clearing agencies will continue to exist and, because they are narrower in scope, would thereby provide a more flexible regime for new entrants seeking to establish and operate registered clearing agencies, consistent with the continuing development of the national system for clearance and settlement, than would otherwise be the case with a single regime under proposed Rule 17Ad-22(e).

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58 See id. (contemplating future Commission action on clearing agency standards).

59 See Clearing Agency Standards Release, supra note 5, at 66227 (stating that Rule 17Ad-22 generally codifies existing practices that reflect the CPSS-IOSCO Recommendations published in 2001 and 2004).

60 See infra Part II.E (discussing the proposed language amending Rule 17Ad-22(d) to apply to registered clearing agencies that are not covered clearing agencies).

The Commission notes that it is not proposing to alter the existing requirements under Rule 17Ad-22(b), which establishes risk-management and participant access requirements for registered clearing agencies that perform CCP services for security-based swaps, or Rule 17Ad-22(c), which requires registered clearing agencies that provide CCP services to maintain a record of financial resources and all registered clearing agencies to post on their websites annual audited financial statements.[61] These requirements continue to be appropriate for all registered clearing agencies because they promote prompt and accurate clearance and settlement of securities and security-based swap transactions. Notably, Rule 17Ad-22(b) reduces the likelihood, in a participant default scenario, that losses from default would disrupt the operations of the clearing agency, and Rule 17Ad-22(c) provides an additional layer of information about the activities and financial strength of a registered clearing agency that market participants may find useful in assessing their use of the registered clearing agency's services while also assisting the Commission in its oversight of registered clearing agencies' compliance with Rule 17Ad-22 by providing a clear record of the method used by the clearing agency to, among other things, maintain sufficient financial resources.[62]

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61 The standards in Rules 17Ad-22(b) and (c) were also adopted by the Commission in 2012. See 17 CFR 240.17Ad-22(b), (c); see also Clearing Agency Standards Release, supra note 5.

The Commission is proposing to revise Rule 17Ad-22(a) to account for new proposed definitions. See proposed revision of Rule 17Ad-22(a), infra Part VII. The existing definitions in 17 CFR 240.17Ad-22(a) would be renumbered to account for new terms. In addition, the definition of "participant family" would be amended to include references to its use in proposed paragraphs (e)(4) and (e)(7). See proposed Rule 17Ad-22(a)(13), infra Part VII.

62 See Exchange Act Release No. 34-64017 (Mar. 3, 2011), 76 FR 14474, 14477-83 (Mar. 16, 2011); see also Clearing Agency Standards Release, supra note 5, at 66244.

A. Overview

The Commission is proposing Rule 17Ad-22(e) to establish requirements for covered clearing agencies with respect to general organization,[63] financial risk management,[64] settlement,[65] CSDs and exchange-of-value settlement systems,[66] default management,[67] general business risk and operational risk management,[68] access,[69] efficiency,[70] and transparency.[71] The discussion below provides greater detail regarding each respective requirement in proposed Rule 17Ad-22(e). Several aspects of proposed Rule 17Ad-22(e) are similar to existing Rule 17Ad-

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63 See infra Parts II.B.1–3 (discussing proposed Rules 17Ad-22(e)(1) (legal risk), 17Ad-22(e)(2) (governance), and 17Ad-22(e)(3) (framework for the comprehensive management of risk)).

64 See infra Part II.B.4 (discussing proposed Rules 17Ad-22(e)(4) (credit risk), 17Ad-22(e)(5) (collateral), 17Ad-22(e)(6) (margin), and 17Ad-22(e)(7) (liquidity risk)).

65 See infra Parts II.B.5–7 (discussing proposed Rules 17Ad-22(e)(8) (settlement finality), 17Ad-22(e)(9) (money settlements), and 17Ad-22(e)(10) (physical delivery risks)).

66 See infra Parts II.B.8–9 (discussing proposed Rules 17Ad-22(e)(11) (CSDs) and 17Ad-22(e)(12) (exchange-of-value settlement systems)).

67 See infra Parts II.B.10–11 (discussing proposed Rules 17Ad-22(e)(13) (participant-default rules and procedures) and 17Ad-22(e)(14) (segregation and portability)).

68 See infra Parts II.B.12–14 (discussing proposed Rules 17Ad-22(e)(15) (general business risk), 17Ad-22(e)(16) (custody and investment risk), and 17Ad-22(e)(17) (operational risk management)).

69 See infra Parts II.B.15–17 (discussing proposed Rules 17Ad-22(e)(18) (access and participation requirements), 17Ad-22(e)(19) (tiered participation arrangements), and 17Ad-22(e)(20) (links)).

70 See infra Parts II.B.18–19 (discussing proposed Rules 17Ad-22(e)(21) (efficiency and effectiveness) and 17Ad-22(e)(22) (communication procedures and standards)).

71 See infra Part II.B.20 (discussing proposed Rule 17Ad-22(e)(23) (disclosure of rules, key procedures, and market data)).

22(d),[72] but in general the Commission preliminarily notes that certain requirements under proposed Rule 17Ad-22(e) would require covered clearing agencies to consider and adopt policies and procedures more closely tailored to the risks that are posed by covered clearing agencies, which the Commission preliminarily identified as appropriate in connection with its experience in supervising registered clearing agencies under Section 17A of the Exchange Act, including since the adoption of Rule 17Ad-22.

The Commission preliminarily believes that the requirements of proposed Rule 17Ad-22(e) would help promote governance, operations, and risk management practices more closely tailored to the risks raised by registered clearing agencies that have been designated systemically important, are engaged in activities with a more complex risk profile, or are determined to be covered clearing agencies by the Commission, consistent with Section 17A of the Exchange Act. The Commission preliminarily believes these requirements would also enable consistent supervision of designated FMUs and would reflect the Commission's consideration of international standards, as contemplated by Section 17A(i) and the Clearing Supervision Act.[73] While the Commission has made its own determination to issue the proposed rules for comment, the Commission preliminarily believes that generally updating its rules, where appropriate, to take into account the standards set forth in the PFMI Report would contribute to the efforts of regulators around the world, described above,[74] to implement consistent standards for FMIs.[75]

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72 See infra Part II.A.4 (discussing the anticipated impact of proposed Rule 17Ad-22(e) given the existing requirements for registered clearing agencies under Rule 17Ad-22).

73 See supra Part I.B.2, in particular notes 36–37 and accompanying text (discussing the requirements under Section 17A(i) of the Exchange Act, 15 U.S.C. 78q-1(i), and Section 805(a) of the Clearing Supervision Act, 12 U.S.C. 5464(a)).

74 See supra note 53 and accompanying text.

The Commission also preliminarily believes that Rule 17Ad-22(e) would provide an additional benefit of providing support for a determination by foreign bank regulators that covered clearing agencies providing CCP services for derivatives and securities financing transactions meet the requirements for QCCP status under the Basel III framework and could therefore help reduce competitive frictions among CCPs in different jurisdictions.

Part II.A first discusses the scope of proposed Rule 17Ad-22(e), the role that written policies and procedures play in framing the proposed rule, and the reasons for imposing certain frequency of review requirements throughout the proposed rules. It then discusses the anticipated impact of the proposed rules given the existing requirements applicable to registered clearing agencies under Rules 17Ad-22(b) through (d), with which a covered clearing agency must already be in compliance.

Part II.B next discusses the proposed rules under Rule 17Ad-22(e). Finally, Parts II.C, D, and E discuss, in turn, proposed Rule 17Ab2-2, proposed Rule 17Ad-22(f), and the proposed amendment to Rule 17Ad-22(d).

1. Scope of Proposed Rule 17Ad-22(e)

The Commission is proposing to add four terms to Rule 17Ad-22(a) to identify the registered clearing agencies that would be subject to proposed Rule 17Ad-22(e). First, the Commission is proposing to add Rule 17Ad-22(a)(9) to define "financial market utility" ("FMU") as defined in Section 803(6) of the Clearing Supervision Act.[76] Second, the

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[75] See infra Part IV.C.1.e (further discussing the economic effects of obtaining QCCP status under the Basel III capital requirements); see also supra note 48.

[76] See proposed Rule 17Ad-22(a)(9), infra Part VII; see also 12 U.S.C. 5462(6) (defining "financial market utility" pursuant to the Clearing Supervision Act); supra note 26 (providing further explanation of "financial market utility").

Commission is proposing Rule 17Ad-22(a)(8) to define "designated clearing agency."[77] A designated clearing agency would mean a clearing agency registered with the Commission under Section 17A of the Exchange Act that has been designated as a systemically important FMU by the FSOC and for which the Commission is the supervisory agency as defined in Section 803(8) of the Clearing Supervision Act.[78] Third, the Commission is proposing to add Rule 17Ad-22(a)(4) to define "clearing agency involved in activities with a more complex risk profile"[79] to mean a clearing agency registered with the Commission under Section 17A of the Exchange Act that either (i) provides central counterparty services for security-based swaps or (ii) has been determined by the Commission to be involved in activities with a more complex risk profile ("complex risk profile clearing agency"), either at the time of its initial registration or upon a subsequent determination by the Commission pursuant to proposed Rule 17Ab2-2.[80] Fourth, the Commission is proposing to add Rule 17Ad-22(a)(7) to define a "covered clearing agency" as a designated clearing agency, a complex risk profile clearing agency, or any clearing agency

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77 See proposed Rule 17Ad-22(a)(8), infra Part VII.

78 Rule 17Ad-22 does not currently apply to entities operating pursuant to an exemption from clearing agency registration. The proposed amendments to Rule 17Ad-22 would not broaden the scope of Rule 17Ad-22 to an entity operating pursuant to an exemption from registration as a clearing agency granted by the Commission.

79 See proposed Rule 17Ad-22(a)(4), infra Part VII.

80 The Commission is proposing Rule 17Ab2-2 to establish a process for making determinations regarding clearing agencies involved in activities with a more complex risk profile. See infra Part II.C (further discussing the purpose, scope, and application of proposed Rule 17Ab2-2) and Part VII (proposed text of Rule 17Ab2-2).

The Commission is also proposing Rule 17Ad-22(a)(16) to define "security-based swap" to mean security-based swap as defined in Section 3(a)(68) of the Exchange Act, 15 U.S.C. 78c(a)(68). See infra Part VII.

determined to be a covered clearing agency by the Commission pursuant to proposed Rule 17Ab2-2.[81]

The Commission preliminarily believes there could be several different bases under which registered clearing agencies would be required to comply with proposed Rule 17Ad-22(e). For instance, because DTC, FICC, NSCC, and OCC are registered clearing agencies pursuant to Section 17A of the Exchange Act and are designated clearing agencies for which the Commission is the supervisory agency under the Clearing Supervision Act,[82] they would be covered clearing agencies under proposed Rule 17Ad-22(a)(7) and would be subject to the requirements for covered clearing agencies in proposed Rule 17Ad-22(e). In addition, because ICEEU provides CCP services for security-based swaps and has been deemed registered with the Commission as a security-based swap clearing agency,[83] it would be a complex risk profile clearing agency under proposed Rule 17Ad-22(a)(4) and also subject to the requirements for covered clearing agencies proposed in Rule 17Ad-22(e).

By comparison, CME and ICE would not be subject to the proposed requirements for covered clearing agencies in Rule 17Ad-22(e) because (i) they have been designated as systemically important FMUs under Section 804 of the Clearing Supervision Act;[84] (ii) they are each dually registered with the Commission and the CFTC as a clearing agency and DCO, respectively; and (iii) the CFTC is their supervisory agency under the Clearing Supervision

81 See proposed Rule 17Ad-22(a)(7), infra Part VII.

82 See supra Part I.B.2.

83 See supra note 41 and accompanying text.

84 See 12 U.S.C. 5463.

Act.[85] The Commission preliminarily believes that, because CME and ICE would be subject to the CFTC's requirements for systemically important DCOs,[86] applying proposed Rule 17Ad-22(e) to them could impose duplicative requirements. Given the Commission's existing regulatory authority under Section 17A(l) of the Exchange Act,[87] however, CME and ICE would remain subject to the continuing requirements for registered clearing agencies in Rules 17Ad-22(b) through (d).

Two dormant clearing agencies, the Stock Clearing Corporation of Philadelphia ("SCCP") and the Boston Stock Exchange Clearing Corporation ("BSECC"), have not been designated systemically important by the FSOC and are not involved in activities with a more complex risk profile.[88] Accordingly, each would also remain subject to the requirements in Rules 17Ad-22(b) through (d).

Further, proposed Rule 17Ab2-2 would provide the Commission flexibility to determine that the operations or circumstances of a registered clearing agency, including a registered clearing agency that is exempt from certain requirements applicable to registered clearing

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85 See supra Part I.B.2; see also FSOC, 2013 Annual Report, supra note 39, at 100.

86 See supra note 41 and accompanying text.

87 See 15 U.S.C. 78q-1(l).

88 In 2008, NASDAQ OMX Group, Inc. acquired SCCP and BSECC. See Exchange Act Release No. 34-58324 (Aug. 7, 2008), 73 FR 46936 (Aug. 12, 2008) (order approving acquisition of BSECC); Exchange Act Release No. 34-58180 (July 17, 2008), 73 FR 42890 (July 23, 2008) (order approving acquisition of SCCP).

Both SCCP and BSECC are currently registered with the Commission as clearing agencies but conduct no clearing or settlement activities. See Exchange Act Release No. 34-63629 (Jan. 3, 2011), 76 FR 1473 (Jan. 10, 2011); Exchange Act Release No. 34-63268 (Nov. 8, 2010), 75 FR 69730 (Nov. 15, 2010).

agencies generally, warrant designation as a covered clearing agency.[89] It would also provide flexibility to make determinations regarding newly registered clearing agencies.

The Commission preliminarily believes the requirements proposed in Rule 17Ad-22(e) aid the regulation of covered clearing agencies by, as noted above, establishing requirements more closely tailored to the risks they pose to the U.S. securities markets. For example, designated clearing agencies are systemically important because of their significance to the U.S. financial system and the risk that the failure of, or a disruption to, their functioning would increase the risk of significant liquidity or credit problems spreading among financial institutions, thereby threatening the stability of the U.S. financial system.[90] Similarly, the Commission preliminarily believes that complex risk profile clearing agencies, such as those providing CCP services for security-based swaps, subject the U.S. securities markets to a material level of systemic risk due to the nature of the products that they clear.[91] The requirements proposed in Rule 17Ad-22(e) are intended to ensure that covered clearing agencies have robust policies and procedures that help promote sound governance, operations, and risk management.

As noted above,[92] the Commission preliminarily believes that establishing separate rules for covered clearing agencies and registered clearing agencies that are not covered clearing

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89 See infra Parts II.C and VII (discussing determinations under proposed Rule 17Ab2-2 and providing rule text, respectively).

90 See supra note 27 and accompanying text.

91 See generally Gov't Accountability Office, Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps (Mar. 2009), available at http://www.gao.gov/new.items/d09397t.pdf.

92 See supra notes 54–61 and accompanying text.

agencies is appropriate given the Commission's goals to facilitate the development of a national system for the prompt and accurate clearance and settlement of securities consistent with Section 17A of the Exchange Act and to mitigate systemic risk consistent with Titles VII and VIII of the Dodd-Frank Act.[93] In this regard, the Commission intends that Rule 17Ad-22(d) would continue to provide minimum requirements for the operation and governance of registered clearing agencies that also facilitate the entrance of new participants, as appropriate, into the market for clearance and settlement services.[94] The Commission preliminarily believes that Rule 17Ad-22(e) would establish new requirements for established participants in the market for clearance and settlement services commensurate to the risks that their size, operation, and importance pose to the U.S. securities markets.[95]

Request for Comments. The Commission generally requests comments on all aspects of the scope of proposed Rule 17Ad-22(e), the relationship between proposed Rule 17Ad-22(e) and Rule 17Ad-22(d), and on proposed Rules 17Ad-22(a)(4), (7), (8), and (9). In addition, the Commission requests comments on the following specific issues:

- Is the scope of proposed Rule 17Ad-22(e) appropriate? Why or why not? Is the scope sufficiently clear? Why or why not? Has the Commission provided sufficient guidance regarding the scope of the proposed rule? Are there aspects of the scope of the proposed

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93 See supra notes 2, 13–14, and accompanying text (noting the goals of, respectively, Section 17A of the Exchange Act and the Dodd-Frank Act).

94 See supra note 43 and accompanying text (noting the Commission's intent in adopting Rule 17Ad-22 in the Clearing Agency Standards Release).

95 See supra note 44 and accompanying text (noting further that the requirements adopted under Rule 17Ad-22 constituted an important first step to enhance the substantive regulation of registered clearing agencies pursuant to the Dodd-Frank Act); see also infra Part IV.C.1.a (addressing systemic risk in the context of discussing the general economic considerations undertaken by the Commission in proposing Rule 17Ad-22(e)).

rule for which the Commission should consider providing additional guidance? If so, please explain.

- Given that all non-dormant registered clearing agencies would either be covered clearing agencies subject to Commission supervision or be subject to CFTC regulation as designated clearing entities for which the CFTC is the supervisory agency, should the Commission replace the existing requirements under Rule 17Ad-22(d) with the requirements proposed under Rule 17Ad-22(e)? Why or why not?
- Is the Commission's proposed definition of "financial market utility" appropriate and sufficiently clear given the proposed requirements? Why or why not? Should the definition be modified? If so, how? Is there an alternative definition the Commission should consider?
- Is the Commission's proposed definition of "designated clearing agency" appropriate and sufficiently clear given the requirements proposed? Why or why not? Should the definition be modified? If so, how? Is there an alternative definition the Commission should consider?
- Is the Commission's proposed definition of "clearing agency involved in activities with a more complex risk profile" appropriate and sufficiently clear given the requirements proposed? Why or why not? Should the definition be modified? If so, how? Is there an alternative definition the Commission should consider?
- Is the Commission's proposed definition of "covered clearing agency" appropriate and sufficiently clear given the requirements proposed? Why or why not? Should the definition be modified? If so, how? Is there an alternative definition the Commission should consider?

- Are the requirements in proposed Rule 17Ad-22(e) necessary, or do the existing provisions in Rule 17Ad-22(d) already sufficiently address the issues identified in this release as justification for increased regulation?

2. Role of Written Policies and Procedures

Proposed Rule 17Ad-22(e) would require covered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, fulfill the requirements set forth in paragraphs (e)(1) through (23) of the proposed rule. The Commission preliminarily believes that this approach would facilitate the Commission's supervision of covered clearing agencies, is appropriate given their role as SROs,[96] and is consistent with the approach taken by the Commission elsewhere in Rule 17Ad-22.[97] The Commission preliminarily believes that, by requiring written policies and procedures and, where appropriate, their disclosure, proposed Rule 17Ad-22(e) should help promote the development of improved standards for clearing agencies by allowing market participants to compare certain of the operations of covered clearing agencies with those of other clearing entities, which choose to make their policies and procedures publicly available or are required to do so by equivalent regulatory standards.[98]

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96 Registered clearing agencies are SROs as defined in Section 3(a)(26) of the Exchange Act, 15 U.S.C. 78c(a)(26). After a clearing agency has been registered with the Commission, the clearing agency, as an SRO, must submit most proposed rule changes to the Commission, for approval pursuant to Rule 19b-4 under the Exchange Act. A stated policy, practice, or interpretation of an SRO, such as a clearing agency's written policies and procedures, would generally be deemed to be a proposed rule change. See 17 CFR 240.19b-4.

97 See Clearing Agency Standards Release, supra note 5, at 66228–29 (describing the scope of Rule 17Ad-22 at adoption).

98 Compare proposed Rule 17Ad-22(e)(23), infra Part VII (requiring public disclosure of, among other things, a covered clearing agency's rules, policies, and procedures) with proposed Reg. HH, supra note 53, at 3666–67, 3686–88, 3693 (the Board proposing disclosure

The Commission is proposing to require policies and procedures developed by each covered clearing agency to fulfill the requirements of proposed Rule 17Ad-22(e) because the Commission preliminarily believes that it is important to allow covered clearing agencies enough flexibility to use their market experience and understanding of their institutions to shape the rules, policies, and procedures implementing proposed Rule 17Ad-22(e). This proposed approach is consistent with the Commission's established approach for supervising SROs; and the Commission preliminarily believes continuing this practice under Rule 17Ad-22(e) will allow the Commission to continue to perform its supervisory function through the SRO rule filing process under Section 19(b) of the Exchange Act and Rule 19b-4,[99] periodic inspections and examinations, other monitoring of the activities of registered clearing agencies, and other established supervisory processes. Because of the importance the Commission gives to both maintaining clearing agency flexibility and to existing oversight mechanisms, the Commission preliminarily believes that the proposed approach is appropriate.

The Commission anticipates that a covered clearing agency's rules, policies, and procedures will need to evolve over time so that it can adequately respond to changes in technology, legal requirements, the needs of its members and their customers, trading volumes, trading practices, linkages between financial markets, and the financial instruments traded in the markets that a covered clearing agency serves. Accordingly, the Commission preliminarily believes that covered clearing agencies should continually evaluate and make appropriate

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requirements intended to be in line with the PFMI Report in Sec. 234.3(a)(23)); DCO Int'l Standards Release, supra note 53, at 72493–94, 72521 (CFTC adopting disclosure requirements intended to be in line with the PFMI Report in Sec. 39.37).

99 See supra note 96 (describing requirements for SROs under the Exchange Act and Rule 19b-4).

updates and improvements to their operations and risk management practices to facilitate prompt and accurate clearance and settlement.

3. Frequency of Review Required Under Certain Policies and Procedures

Many of the policies and procedures requirements proposed in Rule 17Ad-22(e) specify a frequency of review. Generally, the proposed regularity of review falls into three categories—daily, monthly, or annually—and is based on the Commission's understanding of the current review practices generally at covered clearing agencies. The Commission's rationale for these differences is as follows:

- *Daily:* For those activities that the Commission understands to be directly related to the day-to-day operations of a covered clearing agency,[100] such as activities related to the calculation and collection of margin, the Commission preliminarily believes that a covered clearing agency should undertake a daily review and make decisions on a daily basis;
- *Monthly:* For those activities that the Commission understands to coincide with and complement the review and reporting cycles of the governance structures related to the risk management function of the covered clearing agency,[101] the Commission preliminarily believes that a covered clearing agency should undertake a monthly review; based on its supervisory experience, the Commission notes that well-functioning risk management committees of the board and similar management committees or other board or management committees commonly meet or receive reports and other risk

[100] See proposed Rules 17Ad-22(e)(4)(vi)(A); 17Ad-22(e)(6)(ii); 17Ad-22(e)(6)(vi)(A); 17Ad-22(e)(7); 17Ad-22(e)(7)(vi)(A); and 17Ad-22(e)(11)(ii), infra Part VII.

[101] See proposed Rules 17Ad-22(e)(4)(vi)(B); 17Ad-22(e)(4)(vi)(C); 17Ad-22(e)(6)(vi)(B); 17Ad-22(e)(6)(vi)(C); 17Ad-22(e)(7)(vi)(B); and 17Ad-22(e)(7)(vi)(C), infra Part VII.

management information from management on a monthly basis and the monthly requirement would be consistent with such meeting and reporting frequency;

- *Annually:* For those activities that are less integral to day-to-day operations, involve issues that merit review of information collected over longer time periods, or require more high-level review and consideration by, for example, the full board of directors of a clearing agency,[102] the Commission preliminarily believes that a covered clearing agency should undertake an annual review; additionally, the Commission preliminary believes that an annual cycle is appropriate in certain instances because other major reviews such as auditing of the financial statements of registered clearing agencies and their disclosure are required to occur on an annual basis.

Request for Comments: The Commission generally requests comments on all aspects of the frequency of review that would be required to be included in a covered clearing agency's policies and procedures under each of the requirements in proposed Rule 17Ad-22(e). In addition, the Commission requests comments on whether its assessment of daily, monthly, and annual activities at covered clearing agencies is accurate and appropriate given the proposed rules. The Commission also requests comment on what factors should be considered in determining the nature, timing, and extent of the required reviews and whether other frequencies of review might be appropriate under some or all of the proposed rules.

4. Anticipated Impact of Proposed Rule 17Ad-22(e)

Based on the Commission's experience supervising registered clearing agencies, and given the current requirements applicable to registered clearing agencies under Rule 17Ad-22,

[102] See proposed Rules 17Ad-22(e)(3)(i); 17Ad-22(e)(4)(vii); 17Ad-22(e)(5); 17Ad-22(e)(6)(vii); 17Ad-22(e)(7)(v); 17Ad-22(e)(7)(vii); 17Ad-22(e)(7)(x); 17Ad-22(e)(13)(iii); and 17Ad-22(e)(15)(iii), infra Part VII.

the Commission preliminarily anticipates that the degree of changes that covered clearing agencies may need to make to their policies and procedures to satisfy the proposed requirements of Rule 17Ad-22(e) would vary among the particular provisions of the proposed rule and depend in part on the business model and operations of the clearing agency itself, as discussed below. The Commission preliminarily believes that, for the provisions in its proposal where a similar existing requirement has been identified, covered clearing agencies may need to make only limited changes to update their policies and procedures, and the table below provides summary information regarding the Commission's preliminary assessment of the impact of the proposed rules:

Proposed Requirement	Existing Requirement
Rule 17Ad-22(e)(1)	Rule 17Ad-22(d)(1)
Rule 17Ad-22(e)(2)	Rule 17Ad-22(d)(8)
Rule 17Ad-22(e)(3)	None
Rule 17Ad-22(e)(4)	Rules 17Ad-22(b)(1), (b)(3), (d)(14)[103]
Rule 17Ad-22(e)(5)	None

[103] The Commission notes that requirements under Rules 17Ad-22(b) apply only to registered clearing agencies that provide CCP services, the "cover two" requirement under Rule 17Ad-22(b)(3) applies only to registered clearing agencies that provide CCP services for security-based swaps, and requirements under Rule 17Ad-22(d)(14) apply only to registered clearing agencies that provide CSD services. See infra Part II.B.4 (discussing, among other things, the relationship between existing requirements under Rule 17Ad-22 and proposed Rule 17Ad-22(e)(4)); see also 17 CFR 240.17Ad-22; Clearing Agency Standards Release, supra note 5.

Proposed Requirement	Existing Requirement
Rule 17Ad-22(e)(6)	Rule 17Ad-22(b)(2), (b)(4)[104]
Rule 17Ad-22(e)(7)	None
Rule 17Ad-22(e)(8)	Rules 17Ad-22(d)(12)
Rule 17Ad-22(e)(9)	Rule 17Ad-22(d)(5)
Rule 17Ad-22(e)(10)	Rule 17Ad-22(d)(15)
Rule 17Ad-22(e)(11)	Rule 17Ad-22(d)(10)
Rule 17Ad-22(e)(12)	Rule 17Ad-22(d)(13)
Rule 17Ad-22(e)(13)	Rule 17Ad-22(d)(11)
Rule 17Ad-22(e)(14)	None
Rule 17Ad-22(e)(15)	None
Rule 17Ad-22(e)(16)	Rule 17Ad-22(d)(3)
Rule 17Ad-22(e)(17)	Rule 17Ad-22(d)(4)
Rule 17Ad-22(e)(18)	Rules 17Ad-22(b)(5) through (7), (d)(2)
Rule 17Ad-22(e)(19)	None
Rule 17Ad-22(e)(20)	Rule 17Ad-22(d)(7)
Rule 17Ad-22(e)(21)	Rule 17Ad-22(d)(6)
Rule 17Ad-22(e)(22)	None

104 The Commission notes that the relevant requirement in Rule 17Ad-22(b)(4) concerns policies and procedures regarding an annual model validation for margin models while proposed Rule 17Ad-22(e)(6) would impose, in addition to requiring policies and procedures regarding an annual model validation for margin models, additional requirements that do not appear in Rule 17Ad-22(b)(4). See infra Part II.B.4.e (discussing the requirements under proposed Rule 17Ad-22(e)(6)).

Proposed Requirement	Existing Requirement
Rule 17Ad-22(e)(23)	Rule 17Ad-22(d)(9)

With respect to the provisions in its proposal where no similar existing requirement has been identified, the Commission preliminarily anticipates that covered clearing agencies may need to make more extensive changes to their policies and procedures (or implement new policies and procedures), and may need to take other steps, to satisfy the proposed requirements of Rule 17Ad-22(e).

For further discussion of the anticipated impact and costs and benefits of proposed Rule 17Ad-22(e), see Part IV.C.

5. General Request for Comments

The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e) and on all aspects of the definitions included in proposed Rule 17Ad-22(a), as discussed in more detail in Part II.B.[105] In addition, the Commission requests comments on the following issues:

- Is each aspect of proposed Rules 17Ad-22(e)(1) through (23), including any terms used therein, sufficiently clear given the proposed requirements? Why or why not? Has the Commission provided sufficient guidance as to the meaning of each provision of the proposed rules? Are there aspects of the proposed rules for which the Commission should consider providing additional guidance? If so, please explain.
- Are the Commission's definitions in proposed Rule 17Ad-22(a) accurate, appropriate, and sufficiently clear? Why or why not? Should the definitions be modified? If so,

105 Part II.B also contains additional requests for comments on each proposed rule regarding particular issues specific to each proposed rule.

how? Should the Commission adopt alternative definitions than those proposed? Are there additional terms used in Rule 17Ad-22(e) that should be defined? Please explain.

- Is the Commission's use of certain terms it believes to be commonly understood (e.g., "high degree of confidence" or "due diligence") appropriate and accurate? Why or why not?
- Would the proposed rules require covered clearing agencies to change their current practices? If so, how? What are the expected costs and benefits to covered clearing agencies in connection with adding or revising their current practices with respect to the implementation of the Commission's proposed rules?[106]
- Should the Commission consider an alternative approach with respect to written policies and procedures included in the proposed rules? Why or why not? If so, what alternative approaches should the Commission consider? Please explain in detail.
- Should the Commission's proposed rules be less or more prescriptive? Why or why not? If so, what alternative approaches should the Commission consider? Please explain in detail.
- Are there any other factors that the Commission should take into consideration with respect to the requirements of the proposed rules?
- Should there be a phase-in period with respect to any of the requirements of proposed Rule 17Ad-22(e)? If so, what should the phase-in periods be? What facts and circumstances should the Commission consider in evaluating whether to adopt a potential phase-in period? Please explain in detail.

[106] For a complete discussion of the anticipated economic effect of the proposed rules, see Part IV.

- Could the proposed rules affect the ability of covered clearing agencies to compete for certain types of business either within the United States or internationally? If so, how? Please provide specific examples and data.
- Are there significant operational or legal impediments to implementing the proposed rules? Would the proposed rules impact the ability of covered clearing agencies to clear certain products? Are any additional rules or regulations needed to facilitate compliance with the proposed rules?
- Are there any requirements under existing Rule 17Ad-22 that could be viewed as being consistent with the PFMI standards without being supplemented or replaced by new requirements in proposed Rule 17Ad-22(e)? Please explain in detail.

B. Proposed Rule 17Ad-22(e)

1. Proposed Rule 17Ad-22(e)(1): Legal Risk

Proposed Rule 17Ad-22(e)(1) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.[107] Rule 17Ad-22(d)(1) currently requires a registered clearing agency's policies and procedures to meet substantially the same requirement.[108] Because the

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107 See proposed Rule 17Ad-22(e)(1), infra Part VII.

The Commission preliminarily believes that (i) the United States is the relevant jurisdiction for covered clearing agencies that perform the functions of a clearing agency in the United States for purposes of Rule 17Ad-22(e)(1), and (ii) that covered clearing agencies operating in multiple jurisdictions would be required to address any conflicts of laws issues that they may encounter.

108 Rule 17Ad-22(d)(1) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, transparent, and enforceable legal framework for each aspect of its activities in all

requirements under Rule 17Ad-22(d)(1) and proposed Rule 17Ad-22(e)(1) are substantially the same, the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures to comply with the proposed rule.[109]

Consistent with the Exchange Act requirements discussed above,[110] the Commission is proposing Rule 17Ad-22(e)(1) to require that a covered clearing agency have a legal basis for each aspect of its activities in all relevant jurisdictions. The legal framework for a particular clearing agency may cover a broad array of areas and issues, in particular including but not limited to its (i) organizational and governance documents, such as its charter, bylaws, and any charters for board and management committees;[111] (ii) rules, policies, and procedures,[112] including those regarding settlement finality, netting,[113] default of a member, margin,

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relevant jurisdictions. See 17 CFR 240.17Ad-22(d)(1); see also Clearing Agency Standards Release, supra note 5, at 66245–46.

109 See supra Part II.A.4.

110 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

111 The role of governance arrangements in promoting effective risk management has also been a focus of rules proposed by the Commission to mitigate conflicts of interest at certain registered clearing agencies. See Exchange Act Release No. 34-64017 (Mar. 3, 2011), 76 FR 14472 (Mar. 16, 2011) (proposing Rule 17Ad-23 to address conflicts of interest and Rule 17Ad-26 to require standards for board members or board committee directors at registered clearing agencies); Exchange Act Release No. 34-63107 (Oct. 14, 2010), 75 FR 65881, 65893 (Oct. 26, 2010) (proposing Regulation MC to mitigate conflicts of interest at security-based swap clearing agencies).

112 See supra note 96 (describing the requirements in Section 19(b) of the Exchange Act).

113 Netting offsets obligations between or among participants in the netting arrangement, thereby reducing the number and value of payments or deliveries needed to settle a set of transactions. Netting can reduce potential losses in the event of a participant default and may reduce the probability of a default. Netting arrangements can differ as to both timing and the parties to the arrangement: (i) certain netting arrangements net payments or other contractual

collateral,[114] payments, obligations to the participant or default fund, eligibility and participation requirements for members, and recovery and wind-down plans; (iii) contracts (notably including with service providers, settlement banks and liquidity providers); (vi) its use of novation or similar legal devices;[115] and (vii) service restrictions that may be imposed on participants such as restrictions on activities or access.

In addition, the Commission is proposing to add Rule 17Ad-22(a)(20) to define "transparent" to mean, for proposed Rules 17Ad-22(e)(1), (2), and (10), that relevant documentation is disclosed, as appropriate, to the Commission and other relevant authorities, clearing members and customers of clearing members, the owners of the covered clearing agency, and the public, to the extent consistent with other statutory and Commission requirements.[116] In proposing this definition, the Commission recognizes that certain types of

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obligations resulting from market trades (or both) on a continuous basis, while others close-out payments or obligations when an event such as insolvency occurs; and (ii) netting arrangement may net obligations bilaterally among two parties or multilaterally among multiple parties.

114 Collateral arrangements may involve either a pledge or a title transfer. Therefore, regarding pledged assets, a covered clearing agency would examine the degree of legal certainty that a pledge has been validly created in the relevant jurisdiction and, as appropriate, validly perfected. Regarding transfer of title to assets, a covered clearing agency would examine the degree of legal certainty that the transfer is validly created in the relevant jurisdiction and will be enforced.

115 Novation enables a clearing agency to act as a CCP. In novation, the original contract between the buyer and seller is discharged and two new contracts are created, one between the CCP and the buyer and the other between the CCP and the seller. The CCP thereby assumes the original parties' contractual obligations to each other. Legal certainty regarding novation may reinforce market participants' confidence regarding CCP support for or guarantee of the transaction.

116 See proposed Rule 17Ad-22(a)(20), infra Part VII; see also Parts II.B.2 and 7 (discussing proposed Rules 17Ad-22(e)(2) and (10), respectively).

information, such as confidential information, may not be appropriate for public disclosure or disclosure to certain third parties. Confidential information might include, for instance, policies and procedures with respect to the security of information technology or other critical systems or governance arrangements relating to the creation of special advisory committees by the board of directors. With regard to public disclosures contemplated by proposed Rule 17Ad-22(a)(20), a covered clearing agency could comply with the proposed requirement by posting the relevant documentation to a covered clearing agency's website. The Commission preliminarily believes that these disclosures would support a participant's ability to evaluate the risks associated with participating in the covered clearing agency. For example, disclosures that facilitate market participants' understanding of the legal basis for a covered clearing agency's activities and its governance arrangements may encourage participation in the covered clearing agency (with respect to prospective clearing members) and may encourage trading in the United States that would result in clearance and settlement through the covered clearing agency (with respect to prospective investors).

As was the case when the Commission considered Rule 17Ad-22(d)(1), where a clearing agency is faced with significant uncertainty regarding legal risk, the Commission preliminary believes this uncertainty may undermine a covered clearing agency's ability to provide prompt and accurate clearance and settlement, to safeguard securities and funds and to provide fair procedures, as required under Section 17A of the Exchange Act. For example, where a covered clearing agency's procedures addressing a participant default and establishing a security interest in collateral lack clarity or there is significant uncertainty regarding enforceability, there is a risk

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Separately, the Commission has proposed rules to require policies and procedures to protect the confidentiality of trading information and procedures. See Exchange Act Release No. 34-64017 (Mar. 3, 2011), 76 FR 14472 (Mar. 16, 2011) (proposing Rule 17Ad-23).

the clearing agency may face claims to void, stay or reverse its actions, which could be made by a bankruptcy trustee or other type of receiver in an insolvency of a participant, undermining the clearing agency's ability to safeguard securities and funds. As a similar example, if covered clearing agency netting activities are voided or reversed on legal grounds, which could involve a participant's insolvency, clearing and settlement could be disrupted as participant accounts are rebalanced. Also, for example, if a covered clearing agency's plan for recovery and wind-down is subject to legal uncertainty, the covered clearing agency or governmental authorities may be delayed in or prevented from taking appropriate actions, resulting in disorder that may undermine the provision of prompt and accurate clearance and settlement.[117]

Therefore, like Rule 17Ad-22(d)(1), the Commission preliminarily believes that proposed Rule 17Ad-22(e)(1) would support the effectiveness of a covered clearing agency's risk management procedures in two ways. First, by imposing requirements addressing legal risk, it would continue to promote effective risk management at covered clearing agencies. Second, the proposed rule would reinforce covered clearing agency policies and procedures regarding risks other than legal risk, including, among others, credit, liquidity, operational, and general business risk.[118]

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(1) and proposed Rule 17Ad-22(a)(20). In addition, the Commission requests comments on the following specific issues:

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117 Issues addressed in such wind-down plans may include termination, netting, and the transfer of securities positions and assets.

118 Cf. PFMI Report, supra note 1, at 21–25 (discussing Principle 1, legal basis).

- Should the proposed rule include more specific requirements based on the type of business or the types of services offered by covered clearing agencies and/or whether the covered clearing agency operates in multiple jurisdictions? If so, are there any considerations, such as those concerning compliance with regulations in other jurisdictions, the Commission should take into account for covered clearing agencies operating in multiple jurisdictions?
- Should the Commission adopt more prescriptive or less prescriptive rules to define how covered clearing agencies would provide for a well-founded, clear, transparent, and enforceable legal basis? Why or why not? If so, what would those rules be?
- Should the Commission require a covered clearing agency to maintain documentation to demonstrate the legal adequacy of the mechanisms at the clearing agency that are in place to handle participant defaults? If so, what kinds of documentation should the Commission require?
- In proposing Rule 17Ad-22(a)(20), has the Commission taken the right approach with respect to requiring public disclosures? Why or why not? Should the Commission adopt rules that would require either more or less disclosure? Why or why not?
- What should be the minimum level of public disclosure required of a covered clearing agency? What information should a covered clearing agency be permitted to withhold? What form should that disclosure take? What content should be required? Please explain in detail.

2. Proposed Rule 17Ad-22(e)(2): Governance

Proposed Rule 17Ad-22(e)(2)(i) through (iv) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent, clearly prioritize the safety and efficiency of the covered clearing agency, and support the public interest requirements in Section 17A of the Exchange Act and the objectives of owners and participants.[119] The proposed rule contains requirements similar to those currently applicable to registered clearing agencies under Rule 17Ad-22(d)(8), but the proposed rule also requires that a covered clearing agency's policies and procedures provide for governance arrangements that clearly prioritize the safety and efficiency of the covered clearing agency.[120]

Governance arrangements are critical to the sound operation of SROs, including covered clearing agencies.[121] The Exchange Act explicitly conditions clearing agency registration on a clearing agency having rules that (i) assure a fair representation of shareholders or members and participants in the selection of its directors and administration of affairs, (ii) facilitate prompt and accurate clearance and settlement, (iii) protect investors and the public interest, (iv) do not permit unfair discrimination in the use of the clearing agency by participants and (v) provide certain fair

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119 See proposed Rule 17Ad-22(e)(2), infra Part VII. Proposed Rule 17Ad-22(e)(2) would complement other requirements that may apply separately, including requirements in proposed Rules 17Ad-25 and 17Ad-26, and requirements for security-based swap clearing agencies under Section 765 of the Dodd-Frank Act, 12 U.S.C. 8343. See supra note 111 (noting rules proposed by the Commission to address potential conflicts of interest).

120 Specifically, Rule 17Ad-22(d)(8) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Exchange Act applicable to clearing agencies, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures. See 17 CFR 240.17Ad-22(d)(8); see also Clearing Agency Standards Release, supra note 5, at 66251–52.

121 See supra Part I.A and note 96 (describing the Commission's framework for regulation of SROs and the SRO rule filing process).

procedures regarding participants and other interested parties.[122] Accordingly, the proper functioning of registered clearing agencies pursuant to the requirements of the Exchange Act is premised on the existence of a well-organized and operating governance function.

Consistent with these requirements and the Exchange Act requirements discussed above,[123] the Commission preliminarily believes that the governance requirements proposed in Rule 17Ad-22(e)(2) are appropriate because governance arrangements are fundamental to the functioning of a covered clearing agency pursuant to Section 17A of the Exchange Act.[124] Consistent with the Commission's statutory mandate under the Exchange Act, the proposed rule would specify that governance arrangements also be consistent with the public interest requirements in Section 17A of the Exchange Act as applicable to clearing agencies. Because a covered clearing agency's decisions can have widespread impact, affecting multiple market participants, financial institutions, markets, and jurisdictions, the Commission preliminarily believes it is important that each covered clearing agency place a high priority on the safety and efficiency of its operations and explicitly support the objectives of owners and participants. In addition, supporting the public interest is a broad concept that includes, for example, contributing to the ongoing development of the U.S. financial system, in particular the national clearance and settlement system contemplated by Section 17A of the Exchange Act, and protecting investors and fostering fair and efficient markets. The Commission believes that, by supporting the public interest, market participants can develop common processes that help reduce uncertainty in the

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122 See 15 U.S.C. 78q-1(a)(3)(F), (H).

123 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

124 See 15 U.S.C. 78q-1(a)(2)(A).

market, such as industry standards and market protocols related to clearance and settlement that facilitate a common understanding and interactions among clearing agencies and their members. The Commission preliminarily believes that covered clearing agencies, as SROs, are appropriately positioned to determine, based on their experience in providing clearance and settlement services and based on information obtained from their members and other stakeholders, as appropriate in the circumstances, what governance arrangements appropriately support the public interest requirements in Section 17A applicable to clearing agencies consistent with the expectations of such stakeholders,[125] balancing the potentially competing viewpoints of the various stakeholders. The Commission also preliminarily believes that mechanisms through which a covered clearing agency could support the objectives of owners and participants could potentially include representation on the board of directors, user committees, and various public consultation processes.

As with Rule 17Ad-22(d)(8), the Commission preliminarily believes that requiring policies and procedures for clear and transparent governance arrangements support accountability in the decisions, rules, policies, and procedures of the covered clearing agency. Such policies and procedures requirements for governance arrangements provide owners, participants, and, if applicable, general members of the public, with an opportunity to comment on or otherwise provide input to governance arrangements and, in turn, provide a covered clearing agency with the opportunity to balance the potentially competing viewpoints of various stakeholders in its decision making.[126] Similarly, these policies and procedures requirements for

125 See supra note 95 (describing requirements for SROs under the Exchange Act and Rule 19b-4).

126 See id.

governance arrangements may promote the effectiveness of a covered clearing agency's risk management procedures by fostering a focus on the critical role that risk management plays in promoting prompt and accurate clearance and settlement.[127]

In addition, proposed Rule 17Ad-22(e)(2)(iv) would require that the covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements establishing that the board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities.[128] The Commission preliminarily believes that these aspects of a covered clearing agency's governance framework are particularly important and that establishing requirements in these areas would be appropriate given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets.[129]

The Commission preliminarily believes that directors serving on the board and board committees of a clearing agency play an important role in creating a framework that supports prompt and accurate clearance and settlement because of their role in the decision-making process within a clearing agency. Additionally, the Commission preliminarily believes that a covered clearing agency's senior management has an important role in ensuring, under the board's direction, that the clearing agency's activities are consistent with the objectives, strategy, and risk tolerance of the clearing agency, as determined by the board. Accordingly, the expertise

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127 See supra note 111 (discussing rules proposed by the Commission to mitigate conflicts of interest at clearing agencies as part of efforts to promote sound risk management and governance arrangements).

128 See proposed Rule 17Ad-22(e)(2), infra Part VII.

129 For a discussion of current practices at registered clearing agencies regarding boards of directors and senior management, and the anticipated impact of the proposed requirements for governance, see Parts IV.B.3.a.ii and IV.C.3.a.ii, respectively.

and skills of senior management and directors serving on the board of a covered clearing agency are likely to affect its effective operation. For example, a lack of expertise by board members may deter them from challenging decisions by management and lessen the potential that management would escalate appropriate issues to the board for the board's consideration. Similarly, board members and management should not have conflicts of interests that could undermine the decision-making process within a covered clearing agency or interfere with fair representation and equitable treatment of clearing members or other market participants by a covered clearing agency.

The Commission believes that covered clearing agencies are well positioned to determine which individuals would have the appropriate experience, skills, incentives and integrity to discharge their duties and responsibilities that reflect the particular characteristics of each covered clearing agency. Accordingly, the Commission preliminarily believes that the proposed requirement for policies and procedures would provide the covered clearing agency with a process to evaluate the expertise and skills of board members and senior management, consistent with the particular circumstances of the covered clearing agency. Such policies and procedures may include provisions requiring the covered clearing agency to consider, for example, the specific qualifications, experience, competence, character, skills, incentives, integrity or other relevant attributes to support a conclusion that an individual nominee can appropriately serve as a board member or on senior management. Such policies and procedures could also include, among other things, requirements as to industry experience relevant to the services provided by the covered clearing agency, educational background, the absence of a criminal or disciplinary record, or other factors relevant to the qualifications of nominees being considered.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(2). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to provide for governance arrangements that prioritize the safety and efficiency of the covered clearing agency? Why or why not?
- The Commission is not proposing at this time to require a covered clearing agency's policies and procedures provide for governance arrangements that also support the objectives of participants' customers, securities issuers and holders, and other stakeholders. Should the Commission consider such a requirement? Why or why not? Are existing protections under the Exchange Act, such as those in Section 17A(b)(3)(H) (requiring clearing agency rules to provide fair procedures to persons with respect to access to services offered by the clearing agency),[130] Section 17A(b)(5)(B) (establishing requirements for clearing agencies when determining whether a person may be prohibited or limited with respect to services offered),[131] and Section 19(d)(2) (persons aggrieved by SRO actions may apply to the Commission for review)[132] already satisfactory or would additional Commission governance requirements also be appropriate? What would be the possible advantages and disadvantages of expanding the scope of proposed Rule 17Ad-22(e)(2)(iii) to require covered clearing agency policies and procedures to consider the interests of persons other than owners and participants?

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130 See 15 U.S.C. 78q-1(b)(3)(H).

131 See 15 U.S.C. 78q-1(b)(5)(B).

132 See 15 U.S.C. 78s(d)(2).

- Should the Commission require a covered clearing agency's policies and procedures to provide for governance arrangements establishing that the board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities? Why or why not? Has the Commission provided sufficient guidance on what "experience and skills" would require? Why or why not?
- Are there any other requirements that should be included in the rule to promote clear and transparent governance arrangements?
- The Commission is not proposing at this time to require a covered clearing agency's policies and procedures provide for governance arrangements to ensure that lines of responsibility and accountability at the covered clearing agency are clear and direct. Should the Commission consider such a requirement? Why or why not?
- The Commission is not proposing at this time to require a covered clearing agency's policies and procedures provide for governance arrangements that ensure major decisions of the board of directors are disclosed to the public. Should the Commission consider such a requirement? Why or why not?
- Should there be a phase-in period for covered clearing agencies to comply with proposed Rule 17Ad-22(e)(2), such as until the next annual meeting of shareholders of the covered clearing agency or other time period? Why or why not?
- Are the governance requirements in proposed Rule 17Ad-22(e)(2) necessary to achieve the benefits discussed in Part IV.C.3.a.ii? Why or why not? For example, how and why would particular features of the proposed rules, such as expectations that directors and officers of covered clearing agencies have certain skills and experience, contribute to greater market stability and reduced risk of insufficient internal controls endangering

broader financial stability? Are there existing requirements under Section 17A of the Exchange Act, such as the "fair representation" requirement in Section 17A(b)(3)(C), rules and regulations adopted by the Commission and applicable to SROs, or relevant interpretations published by the Commission that already provide a clear and sufficient basis for the Commission to supervise covered clearing agencies in the manner contemplated by proposed Rule 17Ad-22(e)(2) without adopting the proposed rule? What are the possible benefits of adopting the rule as proposed and what possible detriments may arise that the Commission should consider?

- Are there disclosures that a covered clearing agency should be required to make with respect to its governance arrangements? Why or why not? If so, what should be the form and content of those disclosures?
- Should the Commission require that the performance of the board of directors and senior management—individually and as a group—are reviewed on a regular basis? If so, how often should this review be conducted? Should this review be conducted independently?
- Should the board of directors of covered clearing agencies include individuals who are not executives, officers, or employees of the covered clearing agency, or an affiliate of the covered clearing agency? Should the board of directors of covered clearing agencies include an independent audit committee?
- Should the Commission be involved in and/or set requirements and standards with respect to board and management governance at covered clearing agencies? Does the Commission have the requisite statutory authority to adopt the rule proposals and matters addressed in the related questions set forth in this release as to governance arrangements, standards, composition, and qualifications of covered clearing agencies' boards and

management? Is the Commission's oversight and establishment of corporate governance measures and standards at clearing agencies a proper and good use of Commission resources? What are the potential costs and benefits of these corporate governance provisions?

3. Proposed Rule 17Ad-22(e)(3): Framework for the Comprehensive Management of Risks

Proposed Rule 17Ad-22(e)(3) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the covered clearing agency.[133]

Existing Rules 17Ad-22(b) and (d) require registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to meet several requirements that address risk management practices by registered clearing agencies that provide CCP services (Rules 17Ad-22(b)(1) through (4)), certain requirements regarding access to registered clearing agencies that provide CCP services (Rules 17Ad-22(b)(5) through (7)), and certain minimum standards for the operations of registered clearing agencies providing CCP or CSD services.[134] Consistent with these requirements and the Exchange Act requirements

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133 See proposed Rule 17Ad-22(e)(3), infra Part VII.

134 See 17 CFR 240.17Ad-22(b), (d); see also Clearing Agency Standards Release, supra note 5, at 66230–43, 66244–58. Specifically, as examples, Rule 17Ad-22(d)(4) requires a registered clearing agency to have policies and procedures reasonably designed to address certain aspects of operational risk, and Rule 17Ad-22(d)(7) requires a registered clearing agency to have policies and procedures reasonably designed to address certain aspects of risks relating to linkages. See 17 CFR 240.17Ad-22(d)(4), (7).

discussed above,[135] the Commission preliminarily believes that proposed Rule 17Ad-22(e)(3) is appropriate and would require a covered clearing agency's policies and procedures to take a broader, more comprehensive approach to risk management, which the Commission believes is fundamental to a covered clearing agency's functioning given its size, operation, and importance in the U.S. securities markets. While existing rules under the Exchange Act already target certain aspects of risk management, the Commission preliminarily believes that comprehensive risk management policies and procedures established pursuant to proposed Rule 17Ad-22(e)(3) would further support the examination of risks, the assessment of their probability and impact, and the identification of linkages to other entities that in turn pose risks to the covered clearing agency. The Commission also believes that comprehensive risk management policies and procedures would facilitate the development of mechanisms to better prioritize, manage, and monitor risks, and to measure the covered clearing agency's risk tolerance and capacity. In proposing Rule 17Ad-22(e)(3), the Commission is emphasizing a comprehensive approach to risk management that would require risk management policies and procedures be designed holistically, be consistent with each other, and work effectively together in order to mitigate the risk of financial losses to covered clearing agencies' members and participants in the markets they serve.

In addition, policies and procedures for the comprehensive management of risks have the potential to play an important role in making sure that covered clearing agencies better fulfill the Exchange Act requirements that the rules of a clearing agency be designed to protect investors

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135 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

and the public interest.[136] Similarly, these requirements may promote the effectiveness of a covered clearing agency's risk management procedures by fostering a focus on the critical role that risk management plays in promoting prompt and accurate clearance and settlement. Accordingly, the Commission preliminarily believes that it is important that covered clearing agencies have policies and procedures that enable them to identify, monitor, and manage the range of risks that arise in or are borne by all aspects of their clearance and settlement activities.

In addition, the Commission is proposing the requirements described below, which do not appear in existing Rules 17Ad-22(b) or (d). The Commission preliminarily believes these requirements would be appropriate for covered clearing agencies given the risks that their size, operation, and importance pose to the U.S. securities markets.

a. Policies and Procedures Requirements, Periodic Review, and Annual Board Approval

Proposed Rule 17Ad-22(e)(3)(i) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for risk management policies, procedures, and systems designed to identify, measure, monitor, and manage the range of risks that arise in or are borne by the covered clearing agency, and subject them to review on a specified periodic basis and approval by the board of directors annually.[137]

The Commission preliminarily believes periodic review of the risk management policies and procedures would allow covered clearing agencies to assess whether the risk management policies and procedures should be updated to account for changing factors in the market and to

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136 See 15 U.S.C. 78q-1(a)(2).

137 See id.

address and codify in a uniform way the approach to new risks taken since the last periodic review. The Commission preliminarily believes that the board of directors of a covered clearing agency should be required to approve the risk management policies and procedures. The Commission preliminarily believes that, in complying with this requirement, a board of directors may want to subject all material components of the covered clearing agency's risk management policies and procedures to review pursuant to Rule 17Ad-22(e)(3)(i) due to the critical role that risk management plays in promoting prompt and accurate clearance and settlement.

b. Recovery and Orderly Wind-Down Plans

Proposed Rule 17Ad-22(e)(3)(ii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it establishes plans for the recovery and orderly wind-down of the covered clearing agency necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses.[138]

Securities exchanges, market participants, and investors rely upon the safe, sound, and efficient operations of covered clearing agencies, and accordingly the Commission preliminarily believes that a disorderly wind-down of a covered clearing agency would have systemic consequences.[139] The Commission preliminarily believes that a recovery plan designed to deal with possible scenarios that may threaten or potentially prevent a covered clearing agency from being able to provide its critical operations and services as a going concern and that assesses a

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[138] See proposed Rule 17Ad-22(e)(3), infra Part VII.

[139] See generally Clearing Agency Standards Release, supra note 5, at 66283 (noting, in discussing Rule 17Ad-22(d)(11), that having policies and procedures "allow[s] a clearing agency to wind down positions in an orderly way and continue to perform its obligations in the event of a participant default, assuring continued functioning of the securities market in times of stress and reducing systemic risk").

full range of options for recovery could mitigate the impact of a near failure of a covered clearing agency.

Based on its supervisory experience, the Commission recognizes that covered clearing agencies operating in the market today each have relevant standards and practices relating to recovery and orderly wind-down with differing degrees of formality. The Commission therefore preliminarily expects that Rule 17Ad-22(e)(3)(ii) would require covered clearing agencies to review such standards and practices for sufficiency with respect to the safe operation of the covered clearing agency and revise such practices in a manner consistent with the findings of such review consistent with the proposed rule, if adopted, and the requirements of the Exchange Act.

c. Risk Management and Internal Audit

Proposed Rule 17Ad-22(e)(3)(iii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide risk management and internal audit personnel with sufficient authority, resources, independence from management, and access to the board of directors. The Commission preliminarily believes that a covered clearing agency could satisfy the policies and procedures requirement for independence from management by, for example, providing reporting lines for risk management functions that are clear and separate from those for other operations and providing for direct reporting to the board of directors or a relevant committee of the board. In that regard, proposed Rule 17Ad-22(e)(3)(iv) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide risk management and internal audit personnel with oversight by and a direct reporting line to a risk management committee and an audit committee of the board of directors, respectively. Furthermore, proposed Rule 17A-22(e)(3)(v) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for an independent audit committee.

The Commission preliminarily believes that a covered clearing agency should have an effective internal audit function in order to provide, among other things, a rigorous and independent assessment of the effectiveness of the clearing agency's risk management and control processes, and should have an independent audit committee overseeing the internal audit function in order to help promote the integrity and efficiency of the audit process and strengthen internal controls. In order to satisfy the independence requirement for an audit committee under proposed Rule 17Ad-22(e)(2), a covered clearing agency could use such independence criteria as are established by its board of directors. The Commission further preliminarily believes that policies and procedures for risk management are important to the effective operation of a covered clearing agency.

d. Request for Comments

The Commission generally requests comments on all aspects of Proposed Rule 17Ad-22(e)(3). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the covered clearing agency? Why or why not?
- Should the Commission require a covered clearing agency's policies and procedures include plans for the recovery and orderly wind-down of the covered clearing agency necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses? Why or why not?

- How and to whom should the board of directors communicate the results of its review of the risk management framework, if at all?
- Are there any other requirements that should be included in the rule to facilitate policies and procedures that maintain a sound risk management framework, including the proposed requirements for policies and procedures regarding board review and approval of risk management policies and policies and procedures with respect to recovery and orderly wind-down plans? Why or why not? For example, should the Commission require a covered clearing agency's policies and procedures to identify, measure, monitor, and manage the material risks that it poses to other entities, such as other financial market utilities, settlement banks, liquidity providers, or service providers, as a result of interdependencies? Why or why not?
- The Commission is not proposing at this time to require a covered clearing agency's policies and procedures to, in its comprehensive risk management framework, provide for criteria for the independence of audit committee members. Should the Commission consider requirements that specify such criteria? Why or why not? If so, should those criteria be similar to the audit committee independence requirements for listed companies in Rule 10A-3 under the Exchange Act?[140] In order to satisfy the policies and procedures requirement for independence of the audit committee under proposed Rule 17Ad-22(e)(3), should a covered clearing agency be allowed to use such independence criteria as are established by its board of directors?

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140 See 17 CFR 240.10A-3.

4. Proposed Rules 17Ad-22(e)(4) through (7): Financial Risk Management

a. Overview of Financial Risks Faced by Clearing Agencies

Covered clearing agencies face a variety of financial risks from their participants and service providers, including credit or counterparty default risk, market risk, and liquidity risk. For example, for clearing agencies that provide CSD services, credit risk arises from the potential that a participant will not pay what it owes for securities that it has purchased or will not deliver securities that it has sold. For clearing agencies that clear and settle derivatives contracts, credit risk arises from the potential that a participant will not meet its margin or settlement obligations or pay any other amounts owed to the covered clearing agency.[141] Credit risk also arises for clearing agencies of any type from commercial banks or custodians that the covered clearing agency uses to effect money transfers among participants, to hold overnight deposits, or to safeguard cash or other collateral.

Clearing agencies that provide CCP services take offsetting positions as the substituted counterparty to a transaction and, therefore, do not ordinarily face market risk except in the event of a participant default. In such an event, market risk takes two forms. First, the clearing agency may need to liquidate collateral posted by the defaulting participant. The clearing agency is therefore exposed to volatility in the market price of the defaulting participant's non-cash collateral that could result in the clearing agency having insufficient financial resources to cover the losses in the defaulting participant's open positions. Second, a clearing agency providing CCP services is subject to volatility in the market price of the defaulting participant's open

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141 In this context, the clearing agency's credit risk is closely related to the participant's market risk. A participant's ability to meet its obligations to the clearing agency may be affected by the participant's exposure to fluctuations in the market value of the participant's open positions. In addition, fluctuations in the market value of the collateral posted by the participant may require the clearing agency to obtain additional margin from the participant.

positions during the interval between the point at which the clearing agency takes control of those positions and the point at which the clearing agency is able to offset, transfer, or liquidate those positions. A clearing agency faces the risk that its exposure to a participant can change as a result of a change in prices, positions, or both.

A clearing agency must be able to measure the counterparty credit exposures that it is expected to manage effectively. A clearing agency can ascertain its current credit exposure to each participant by marking each participant's outstanding positions to current market prices and (to the extent permitted by a clearing agency's rules and supported by law) netting any gains against any losses.

In addition to credit risk and market risk, clearing agencies also face liquidity or funding risk. Currently, to complete the settlement process, clearing agencies generally rely on incoming payments from participants in net debit positions in order to make payments to participants in net credit positions. If a participant does not have sufficient funds to make an incoming payment immediately when it is due (even though it may be able to pay at some future time), or if a settlement bank is unable to make an incoming payment on behalf of a participant, the clearing agency faces a funding shortfall. A clearing agency typically holds additional financial resources to cover potential funding shortfalls such as margin collateral or lines of credit. However, if collateral cannot be liquidated within a short time, or if lines of credit are unavailable, liquidity risk would be exacerbated.

b. Current Financial Risk Management Requirements for CCPs

Rules 17Ad-22(b)(1) through (4) concern risk management requirements for clearing agencies that perform CCP services (hereinafter "CCPs" in this part). Rule 17Ad-22(b)(1) requires that CCPs establish, implement, maintain and enforce written policies and procedures reasonably designed to measure their credit exposures at least once per day.[142] Rule 17Ad-22(b)(2) requires that CCPs establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit their exposures to participants.[143] This margin can also be used to reduce a CCP's losses in the event of a participant default. Rule 17Ad-22(b)(3) requires that CCPs establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which a CCP has the largest exposure in extreme but plausible market conditions, except that CCPs clearing security-based swap transactions must maintain additional financial resources sufficient to withstand the simultaneous default by the two participant families to which a CCP has the largest exposures.[144] Finally, Rule 17Ad-22(b)(4) requires that CCPs establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for an annual model validation that consists of evaluating the performance of a clearing agency's margin models and the related parameters and assumptions associated with such models and that is performed by a qualified person who is free from influence from the persons responsible for development or operation of the models being validated.[145]

c. Proposed Rule 17Ad-22(e)(4): Credit Risk

Proposed Rule 17Ad-22(e)(4) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to

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142 See 17 CFR 240.17Ad-22(b)(1).

143 See 17 CFR 240.17Ad-22(b)(2).

144 See 17 CFR 240.17Ad-22(b)(3).

145 See 17 CFR 240.17Ad-22(b)(4).

effectively identify, measure, monitor, and manage its credit exposures to participants and those exposures arising from its payment, clearing, and settlement processes.[146] The Commission preliminarily believes the proposed rule is consistent with the requirements of the Exchange Act discussed above.[147]

Proposed Rule 17Ad-22(e)(4)(i) would require a covered clearing to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. The Commission's intention in proposing the term "high degree of confidence" is to refer to the statistical meaning of this term.[148] The proposed rule would require a covered clearing agency to use statistical methods to develop models in order to estimate the financial resources required under proposed Rule 17Ad-22(e)(4)(ii) and (iii),[149] and to comply with the requirements of proposed Rule 17Ad-22(e)(4)(ii) and (iii), while recognizing that such an approach is necessarily imprecise to at least some degree.

Proposed Rule 17Ad-22(e)(4)(ii) would require a covered clearing agency that provides CCP services, and that is "systemically important in multiple jurisdictions" or "a clearing agency involved in activities with a more complex risk profile," to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain additional financial

146 See proposed Rule 17Ad-22(e)(4), infra Part VII.

147 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

148 See, e.g., Arthur S. Goldberger, A Course in Econometrics 122–23 (Harvard Univ. Press, 2003) (defining confidence intervals for parameter estimates).

149 See supra Part II.B.4.a (noting that a clearing agency must be able to measure the counterparty credit exposures in order to manage risk effectively).

resources, to the extent not already maintained pursuant to proposed Rule 17Ad-22(e)(4)(i), at a minimum level necessary to enable it to cover a wide range of foreseeable stress scenarios, including but not limited to the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions (hereinafter the "cover two" requirement).

Proposed Rule 17Ad-22(e)(4)(iii) would require a covered clearing agency that is not subject to proposed Rule 17Ad-22(e)(4)(ii) to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain additional financial resources, to the extent not already maintained pursuant to proposed Rule 17Ad-22(e)(4)(i), at the minimum to enable it to cover a wide range of foreseeable stress scenarios, including the default of the participant family that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions (hereinafter the "cover one" requirement).[150] The Commission notes that the requirement in proposed Rules 17Ad-22(e)(4)(ii) and (iii) to examine exposure under foreseeable stress scenarios including extreme but plausible market conditions means the covered clearing agency may need to use models to determine how its estimated exposure under such conditions differs from its actual exposure to positions of such participants, which it would be required to measure under proposed Rule 17Ad-22(e)(4)(i).

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[150] The Commission notes that, with the exception of security-based swap clearing agencies, all registered clearing agencies providing CCP services are all currently required to meet a "cover one" standard under Rule 17Ad-22(b)(3), and therefore the Commission anticipates that covered clearing agencies may need to make only limited changes to policies and procedures to satisfy the proposed requirement, if adopted. See infra Parts IV.B.3.b.i and IV.C.3.a.iv(1) (discussing current practices at registered clearing agencies relating to credit risk and the anticipated economic effect of the proposed requirement, respectively).

Also, as previously discussed, the Commission is proposing Rule 17Ad-22(a)(4) to define "clearing agency involved in activities with a more complex risk profile."[151] The Commission is also proposing Rule 17Ad-22(a)(19) to define "systemically important in multiple jurisdictions" to mean a covered clearing agency that has been determined by the Commission to be systemically important in more than one jurisdiction pursuant to Rule 17Ab2-2.[152]

Like the "cover two" requirement in Rule 17Ad-22(b)(3), which applies to registered clearing agencies that provide CCP services for security-based swaps,[153] proposed Rule 17Ad-22(e)(4)(ii) would impose a "cover two" requirement to address credit risk of certain covered clearing agencies: those systemically important in multiple jurisdictions and those involved in activities with a more complex risk profile. The Commission notes that the set of complex risk profile clearing agencies subject to this requirement would include, as of the date of this proposal, only registered clearing agencies that provide CCP services for security-based swaps, which are already subject to the "cover two" requirement in Rule 17Ad-22(b)(3). In addition, the Commission notes that no covered clearing agency would be systemically important in multiple jurisdictions unless and until the Commission made such a determination pursuant to proposed Rule 17Ab2-2.[154] For any covered clearing agency not currently subject to a "cover

151 See supra Part II.A.1 (discussing the scope of proposed Rule 17Ad-22(e)); supra notes 79–80 and accompanying text.

152 See proposed Rule 17Ad-22(a)(19), infra Part VII; see also infra Parts II.C and VII (discussing the determinations process under proposed Rule 17Ab2-2 and providing proposed rule text).

153 See 17 CFR 240.17Ad-22(b)(3); see also infra Part II.A.1 (discussing the scope of proposed Rule 17Ad-22(e)); Clearing Agency Standards Release, supra note 5, at 66233–36 (discussing proposed Rule 17Ad-22(b)(3)).

154 See infra Parts II.C and VII (discussing the determinations process under proposed Rule 17Ab2-2 and providing proposed rule text).

two" requirement that could be determined by the Commission in the future to be either systemically important in multiple jurisdictions or involved in activities with a more complex risk profile, the Commission believes that requiring such entities to improve their resilience to offset increased risk and to prepare for extreme but plausible market conditions is appropriate because it could decrease the likelihood that systemic events in other jurisdictions or extreme volatility in more complex financial instruments would result in interruptions to the provision of clearance and settlement services in the U.S. securities markets.

In addition, the Commission is proposing the requirements described below. In discussing these requirements, the below sections describe how they differ from existing requirements in Rules 17Ad-22(b)(1) through (4) applicable to security-based swap clearing agencies, previously discussed above.[155]

i. Prefunded Financial Resources

Proposed Rule 17Ad-22(e)(4)(iv) would require a covered clearing agency providing CCP services that is either systemically important in multiple jurisdictions or a complex risk profile clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to include prefunded financial resources, excluding assessments for additional guaranty fund contributions or other resources that are not prefunded, when calculating the financial resources available to meet the standards under proposed Rules 17Ad-22(e)(4)(i) through (iii), as applicable.[156] The Commission preliminarily believes that prefunding default obligations is appropriate because of the importance of the ability of a covered clearing agency to meet its default resource obligations to the clearance and settlement

155 See supra Part II.B.4.b.

156 See proposed Rule 17Ad-22(e)(4)(iv), infra Part VII.

system, given the risks that its size, operation, and importance pose to the U.S. securities markets.[157] Immediately available financial resources are necessary to ensure that a covered clearing agency can meet its financial obligations on an ongoing basis. Without prefunded financial resources, a covered clearing agency may be unable to meet its financial obligations in stressed market conditions, when clearing members may be unwilling or unable to contribute to the clearing agency's guaranty fund in the event of a member default.

The Commission notes that while the ability to assess participants for contributions under applicable covered clearing agency governing documents, rules, or agreements could not be included in this calculation, previously paid-in participant contributions into a covered clearing agency default fund could be counted to the extent the clearing agency's rules, policies, or procedures permit such resources to be used in a manner equivalent to other financial resources in the default fund. Other sources of prefunded resources, such as margin previously posted to the clearing agency by participants, could also be treated in this manner. In addition, while the ability to draw down under a revolving loan facility could not be counted towards prefunded resources because funds from such loan facility would not be in the covered clearing agency's immediate possession, the covered clearing agency could count borrowed funds already drawn down, such as under a term loan or other credit facility.

Existing requirements under Rule 17Ad-22 do not include requirements for prefunded financial resources at registered clearing agencies. The proposed requirement reflects the Commission's recognition of the importance of a covered clearing agency meeting its default

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[157] See generally 12 U.S.C. 5461 (Congress finding, among other things, that enhancements to the regulation and supervision of systemically important FMUs and the conduct of systemically important PCS activities by financial institutions are necessary, under Title VIII, to provide consistency, to promote robust risk management and safety and soundness, to reduce systemic risks, and to support the stability of the broader financial system).

resource obligations, given the risks that its size, operation, and importance pose to the U.S. securities markets.

ii. Combined or Separately Maintained Clearing or Guaranty Funds

Proposed Rule 17Ad-22(e)(4)(v) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain the financial resources required under proposed Rules 17Ad-22(e)(4)(i) through (iii) in combined or separately maintained clearing or guaranty funds.[158] The proposed rule makes clear that a covered clearing agency may choose to maintain a separate default fund for purposes of complying with proposed Rules 17Ad-22(e)(4)(i) through (iii).

This requirement would be similar to the requirement in Rule 17Ad-22(b)(3) requiring a security-based swap clearing agency to have policies and procedures reasonably designed to maintain financial resources generally or in separately maintained funds.[159] The Commission believes that this approach facilitates the operations of clearing agencies. For example, clearing agencies may maintain separate default funds for each product or asset type cleared, in order to more appropriately tailor risk management requirements or contain losses from a default to that fund.

iii. Testing the Sufficiency of Financial Resources

Proposed Rule 17Ad-22(e)(4)(vi) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to test the

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158 See proposed Rule 17Ad-22(e)(4)(v), infra Part VII.

159 Rule 17Ad-22(b)(3) currently also permits a security-based swap clearing agency to have policies and procedures reasonably designed to maintain financial resources generally or in separately maintained funds. See 17 CFR 240.17Ad-22(b)(3); see also Clearing Agency Standards Release, supra note 5, at 66233–236.

sufficiency of its total financial resources available to meet the minimum financial resource requirements under proposed Rules 17Ad-22(e)(4)(i) through (iii), as applicable, by conducting a stress test of its total financial resources at least once each day using standard predetermined parameters and assumptions.[160] Registered clearing agencies are not subject to requirements for testing the sufficiency of their financial resources under existing Rule 17Ad-22.

The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to conduct a comprehensive analysis on at least a monthly basis of the existing stress testing scenarios, models, and underlying parameters and assumptions, and consider modifications to ensure they are appropriate for determining the covered clearing agency's required level of default protection in light of current market conditions. When the products cleared or markets served by a covered clearing agency display high volatility, become less liquid, or when the size or concentration of positions held by the entity's participants increases significantly, the proposed rule would specifically require a covered clearing agency to have policies and procedures for conducting comprehensive analyses of stress testing scenarios, models, and underlying parameters and assumptions more frequently than monthly. The Commission preliminarily believes that what constitutes "high volatility" and "low liquidity" would vary across asset classes that a covered clearing agency might clear. Accordingly, the Commission preliminarily believes that a clearing agency would need flexibility to address changing circumstances and is therefore not proposing to prescribe triggers for any particular circumstance.

The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for the

160 See proposed Rule 17Ad-22(e)(4)(vi), infra Part VII.

reporting of the results of this analysis to the appropriate decision makers at the covered clearing agency, including its risk management committee or board of directors, and to require the use of the results to evaluate the adequacy of and to adjust its margin methodology, model parameters, and any other relevant aspects of its credit risk management policies and procedures, in supporting compliance with the minimum financial resources requirements discussed above.

The Commission is also proposing to add Rule 17Ad-22(a)(18) to define "stress testing" to mean the estimation of credit and liquidity exposures that would result from the realization of extreme but plausible price changes or changes in other valuation inputs and assumptions.[161] The Commission preliminarily believes that stress testing is an important component of the proposed rules because stress testing may enable a covered clearing agency to be prepared for an extreme event that may not be anticipated or expected based solely on current market conditions or from a sample of historical data.

The Commission preliminarily believes that the requirements in proposed Rule 17Ad-22(e)(4)(vi) are appropriate for testing the sufficiency of the financial resources of covered clearing agencies because, in certain market conditions, such as periods of high volatility or diminished liquidity, existing stress scenarios, models, or underlying parameters may no longer be valid or appropriate. Based on its supervisory experience, the Commission believes that certain, but not all, covered clearing agencies adjusted their stress testing scenarios following the 2008 financial crisis to incorporate larger debt, equity, and credit market shocks similar to those experienced during the crisis. Accordingly, the Commission preliminarily believes that specific policies and procedures contemplating actions to be taken by all covered clearing agencies in such circumstances are necessary to ensure the safe functioning of the covered clearing agencies

161 See proposed Rule 17Ad-22(a)(18), infra Part VII.

as required by the Exchange Act,[162] and that requiring periodic feedback and analysis on the strength of credit risk management policies and procedures would improve the reliability of those policies and procedures. The Commission also preliminarily believes that the rule would provide a covered clearing agency with the flexibility to use stress scenarios that are appropriately tailored to current market conditions and that can be revised over time as markets change and believes that such flexibility is appropriate to achieve the objectives of the Exchange Act.

iv. Annual Conforming Model Validation

Proposed Rule 17Ad-22(e)(4)(vii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require a conforming model validation for its credit risk models to be performed not less than annually or more frequently as may be contemplated by the covered clearing agency's risk management policies and procedures.[163] The Commission preliminary believes that an annual cycle is appropriate for the reasons described in Part II.A.3. The Commission notes that other important reviews such as auditing of the financial statements of registered clearing agencies and their disclosure are required to occur on an annual basis as well.[164]

The Commission is proposing to add Rule 17Ad-22(a)(5) to define "conforming model validation" to mean an evaluation of the performance of each material risk management model used by a covered clearing agency, along with the related parameters and assumptions associated

162 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

163 See proposed Rule 17Ad-22(e)(4)(vii), infra Part VII.

164 See 17 CFR 240.17Ad-22(c)(2).

with such models.[165] Such model validation would apply to models that would include initial margin models, liquidity risk models, and models used to generate clearing or guaranty fund requirements. A conforming model validation would also require that the model validation be performed by a qualified person who is free from influence from the persons responsible for the development or operation of the models or policies being validated so that credit risk models can be candidly assessed.[166] Generally, the Commission considers that a person is free from influence when that person does not perform functions associated with the clearing agency's models (except as part of the annual model validation) and does not report to a person who performs these functions. The Commission generally would not expect that it would be necessary for policies and procedures adopted pursuant to this proposed requirement to require the clearing agency to separate organizationally model review from model development or to maintain two separate quantitative teams.

The proposed rule differs from the existing requirement for security-based swap clearing agencies in Rule 17Ad-22(b)(4) by defining in explicit terms the requirements for a conforming model validation and by requiring it for credit risk models.[167] The proposed rule would also

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165 See proposed Rule 17Ad-22(a)(5), infra Part VII.

166 See Clearing Agency Standards Release, supra note 5, at 66238.

167 Rule 17Ad-22(b)(4) requires a security-based swap clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for an annual model validation consisting of evaluating the performance of the clearing agency's margin models and the related parameters and assumptions associated with such models by a qualified person who is free from influence from the persons responsible for the development or operation of the models being validated. See 17 CFR 240.17Ad-22(b)(4); see also Clearing Agency Standards Release, supra note 5, at 66236–238.

In contrast to proposed Rules 17Ad-22(a)(5) and (e)(4)(vii), Rule 17Ad-22(b)(4) requires only a model validation for margin models and does not specify the general elements of a model validation.

apply to any covered clearing agency, and not only security-based swap clearing agencies. The Commission preliminarily believes, because credit risk models play an important role in limiting systemic risk, that it is important to create a consistent, clear, and uniformly applied minimum standard for model validation across all covered clearing agencies.[168] The Commission also preliminarily believes that annual conforming model validation would provide unbiased feedback on the performance of such models and policies, and therefore could improve their reliability.

d. Proposed Rule 17Ad-22(e)(5): Collateral

Proposed Rule 17Ad-22(e)(5) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to limit the assets it accepts as collateral to those with low credit, liquidity, and market risks, and also require policies that set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its own or its participants' credit exposures.[169] The proposed rule includes requirements similar to those applicable to registered clearing agencies under Rule 17Ad-22(d)(3) but would, in addition, require a covered clearing agency's policies and procedures to set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its own or its participants' credit exposures.[170]

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168 See generally Clearing Agency Standards Release, supra note 5, at 66238.

169 See proposed Rule 17Ad-22(e)(5), infra Part VII.

170 Registered clearing agencies are currently subject to requirements under Rule 17Ad-22(d)(3), which requires registered clearing agencies to hold assets in a manner that minimizes risk of loss or risk of delay in access to them and invest assets in instruments with minimal credit, market, and liquidity risk. See 17 CFR 240.17Ad-22(d)(3); see also Clearing Agency

The Commission is proposing Rule 17Ad-22(e)(5) to require policies and procedures with respect to specific practices to be followed by a covered clearing agency when managing collateral to ensure the safeguarding of funds, consistent with the requirements under the Exchange Act discussed above.[171] In doing so, proposed Rule 17Ad-22(e)(5) would promote confidence that covered clearing agencies are able to meet their settlement obligations by reducing the likelihood that assets securing participant obligations to the covered clearing agency would be unavailable or insufficient when the covered clearing agency needs to draw on them. Specifically, such requirements recognize the role played by system-wide asset price deterioration in generating systemic risk and the vulnerability a covered clearing agency could face if posted collateral were concentrated in assets that subsequently experience such deterioration in price.[172] The Commission preliminarily believes the proposed rule is appropriate given the risks that its size, operation, and importance pose to the U.S. securities markets, thereby promoting stability in the national system for clearance and settlement by increasing the likelihood collateral holdings will function as designed when faced with stressed market conditions.

Standards Release, supra note 5, at 66247–48; infra Part II.B.13 (discussing proposed Rule 17Ad-22(e)(16)).

Similarly, the Commission preliminarily believes that appropriately conservative haircuts and concentration limits would require a covered clearing agency to value assets in a manner that minimizes risk of loss or risk of delay in access to them.

171 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

172 See, e.g., Mark Roe, Clearinghouse Overconfidence (Aug. 11, 2013), available at http://ssrn.com/abstract=2224305 (discussing the risks posed to clearing agencies by asset price deterioration).

In addition, the Commission is proposing that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to include a not-less-than-annual review of the sufficiency of a covered clearing agency's collateral haircuts and concentration limits.[173] Rule 17Ad-22(d) does not impose a similar requirement on registered clearing agencies. The Commission preliminarily believes that the proposed approach is appropriate because of the importance of collateral haircuts and concentration limits to a covered clearing agency's risk management policies and procedures. Because of the role collateral plays in a default, a covered clearing agency needs assurance of its value in the event of liquidation, as well as the capacity to draw upon that collateral promptly. The Commission preliminarily believes, given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets, that it is important to require policies and procedures for a not-less-than-annual review of the sufficiency of its collateral haircuts and concentration limits.[174]

e. Proposed Rule 17Ad-22(e)(6): Margin

Generally, proposed Rule 17Ad-22(e)(6) would require a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that is monitored by management on an ongoing basis and regularly reviewed, tested, and verified.[175]

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173 See proposed Rule 17Ad-22(e)(5), infra Part VII.

174 See supra Part II.A.3 (discussing the Commission's rationale for imposing varying frequencies of review under certain policies and procedures requirements of the proposed rules).

175 See proposed Rule 17Ad-22(e)(6), infra Part VII.

Rule 17Ad-22(b)(2) currently requires registered clearing agencies that provide CCP services to use risk-based models and parameters to set margin requirements, and to review such margin requirements and the risk-based models and parameters at least monthly;[176] and the proposed rule would impose substantially the same requirements.[177] Rule 17Ad-22(b)(4) also currently requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for an annual model validation consisting of evaluating the performance of the clearing agency's margin models and the related parameters and assumptions associated with such models by a qualified person who is free from influence from the persons responsible for the development or operation of the models being validated.

The Commission notes that proposed Rule 17Ad-22(e)(6) is different from these existing requirements under Rule 17Ad-22, as discussed below. The proposed requirements reflect more specific recognition by the Commission of the importance margin plays in risk management by covered clearing agencies. The Commission preliminarily believes that these requirements for a covered clearing agency to periodically verify and modify margin requirements in light of changing market conditions would be appropriate to mitigate the risks posed by a covered clearing agency to financial markets in periods of financial stress considering the risks that its size, operation, and importance pose to the U.S. securities markets.

176 See 17 CFR 240.17Ad-22(b)(2).

177 Similar to Rule 17Ad-22(b)(2), proposed Rule 17Ad-22(e)(6)(vi) would require a covered clearing agency to conduct on at least a monthly basis a conforming sensitivity analysis of its margin resources and its parameters and assumptions for backtesting. See infra Parts II.B.4.e.vi and VII.

i. **Active Management of Model Risk**

Proposed Rule 17Ad-22(e)(6)(i) would require a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to result in a margin system that at a minimum considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.[178] The complexity and product risk characteristics of the cleared product and underlying instrument can influence the margin requirements necessary to manage the credit exposures posed by a covered clearing agency's participants. Additionally, the volume of trading may also influence the margin requirements necessary to manage the credit exposures proposed by a covered clearing agency's participants. The Commission preliminarily believes that expressly requiring policies and procedures regarding the active management of a covered clearing agency's margin system to account for those factors and differences would help ensure the effectiveness of a covered clearing agency's risk management practices.

ii. **Collection of Margin**

Proposed Rule 17Ad-22(e)(6)(ii) would require a covered clearing agency that provides CCP services to establish implement, maintain and enforce written policies and procedures reasonably designed to ensure that the margin system would mark participant positions to market and collect margin, including variation margin or equivalent charges if relevant, at least daily, and include the authority and operational capacity to make intraday margin calls in defined circumstances.[179] The Commission preliminarily believes that marking each participant's outstanding positions to current market prices is an important feature of an effective margin

178 See proposed Rule 17Ad-22(e)(6)(i), infra Part VII.

179 See proposed Rule 17Ad-22(e)(6)(ii), infra Part VII.

system because adverse price movements can rapidly increase a covered clearing agency's exposures to its participants. Rule 17Ad-22(b)(2) requires registered clearing agencies that provide CCP services to calculate margin requirements daily. The Commission preliminarily believes that requiring a covered clearing agency to have the authority and operational capacity to make intraday margin calls in defined circumstances will benefit covered clearing agencies by covering settlement risk created by intraday price movements. By being more specific with respect to its expectations for collecting sufficient margin and having other liquid resources at its disposal, the Commission expects that a covered clearing agency will be better able to organize its practices accordingly, to limit its exposures to potential losses from defaults by clearing members in normal market conditions considering the risks that its size, operation, and importance pose to the U.S. securities markets.[180]

iii. Ninety-Nine Percent Confidence Level

Proposed Rule 17Ad-22(e)(6)(iii) would require a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to calculate margin sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default.[181] The Commission is proposing to add Rule 17Ad-22(a)(14) to define "potential future exposure" to mean the maximum exposure estimated to occur at a future point in time with an established single-tailed confidence level of at least 99% with respect to the estimated distribution of future exposure.[182] The Commission preliminarily believes that a 99%

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[180] See Clearing Agency Standards Release, supra note 5, at 66231.

[181] See proposed Rule 17Ad-22(e)(6)(iii), infra Part VII.

[182] See proposed Rule 17Ad-22(a)(14), infra Part VII.

confidence level is an appropriately conservative setting that is also consistent with the international standard for bank capital requirements, which requires banks to measure market risks at a 99% confidence interval when determining regulatory capital requirements.[183]

The Commission preliminarily believes that, rather than establish specific criteria in advance, it is more appropriate to address liquidation periods separately with respect to each covered clearing agency through the Commission's supervisory process under Sections 17A and 19 of the Exchange Act,[184] so that the length of the liquidation period can be appropriately tailored to the characteristics of the products cleared by the covered clearing agency as financial markets evolve.

iv. Price Data Source

Proposed Rule 17Ad-22(e)(6)(iv) would require a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it uses reliable sources of timely price data and procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable.[185] The Commission preliminarily believes that a covered clearing agency should use reliable sources of timely price data because its margin system needs such data to

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183 See Clearing Agency Standards Release, supra note 5, at 66226 (describing the history of usage for a 99% confidence interval). A 99% confidence level would represent one day of actual trading losses that exceeded the results predicted by the model (as revealed by backtesting) for every 100 days that trading occurred. See id. Requiring a covered clearing agency to have policies and procedures with a higher or lower confidence level than that currently used by its clearing members could potentially create incentives or disincentives for clearing members to clear based on the statistical confidence level alone.

184 See supra Part I.A (discussing the regulatory framework under Section 17A of the Exchange Act); supra note 96 (describing the requirements in Section 19(b) of the Exchange Act).

185 See proposed Rule 17Ad-22(e)(6)(iv), infra Part VII.

operate with a high degree of accuracy and reliability, given the risks that the covered clearing agency's size, operation, and importance pose to the U.S. securities markets.[186] Based on its supervisory experience, the Commission preliminarily believes that reliable data sources may include the following features, among other things: (i) provision of data by the data source that is accurate, complete, and timely; (ii) capability of the data source to provide broad data sets to the covered clearing agency; and (iii) limited need for manual intervention by the clearing agency. In some situations, price data may not be available or reliable, such as in instances where third party data providers experience lapses in service or where limited liquidity otherwise makes price discovery difficult. Establishing appropriate procedures and sound valuation models is a useful step a covered clearing agency can take to help protect itself in such situations. The Commission preliminarily believes, in selecting price data sources, a covered clearing agency should consider the likelihood of the data being provided under a variety of market conditions and not select price data sources based on their cost alone.

v. Method for Measuring Credit Exposure

Proposed Rule 17Ad-22(e)(6)(v) would require a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the use of an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products. Measuring such portfolio effects means a covered clearing agency may take into account certain netting procedures or offsets through which credit exposure may be reduced in measuring credit exposure, including the use of portfolio margining procedures across products where

186 Cf. PFMI Report, supra note 1, at 51 (discussing Principle 6, margin).

applicable.[187] The Commission preliminarily believes that this proposed requirement that covered clearing agencies contemplate both product level and portfolio level effects when considering and measuring their credit exposure is appropriate, given that the method for measuring credit exposure will determine the accuracy of a covered clearing agency's measurements in practice.

vi. Backtesting and Sensitivity Analysis

Under proposed Rule 17Ad-22(e)(6)(vi), in addition to the requirement discussed above, in relation to monitoring by management on an ongoing basis, a covered clearing agency that provides CCP services would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to regularly review, test, and verify its risk-based margin system by conducting backtests at least once each day and conducting a conforming sensitivity analysis of its margin resources and its parameters and assumptions for backtesting at least monthly, and consider modifications to ensure the backtesting practices are appropriate for determining the adequacy of its margin resources.[188] The Commission preliminarily believes that, since margin positions must be calculated at least daily, policies and procedures should also provide for daily backtesting. The Commission preliminarily believes that requiring, on at least a monthly basis, a conforming sensitivity analysis of margin resources and parameters and assumptions for backtesting would appropriately balance cost concerns with the interest of assuring that risk margin methodologies continue to reflect current conditions. The Commission notes that, based on its supervisory experience, risk management committees of the board and similar management committees of registered clearing agencies commonly meet on a monthly

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187 See proposed Rule 17Ad-22(e)(6)(v), infra Part VII.

188 See proposed Rule 17Ad-22(e)(6)(vi), infra Part VII.

basis, and therefore the proposed requirement of a monthly sensitivity analysis would be consistent with such meeting frequency.

Backtesting is a technique used to compare the potential losses forecasted by a model with the actual losses that participants incurred, and is intended to reveal the accuracy of models. Misspecified or miscalibrated models may lead to errors in decision making. The Commission is proposing to require policies and procedures that provide for backtesting the margin models used by covered clearing agencies to help uncover and address possible errors in model design, misapplication of models, or errors in the inputs to, and assumptions underlying, margin models. The Commission is also proposing to add Rule 17Ad-22(a)(1) to define "backtesting" to mean an ex-post comparison of actual outcomes with expected outcomes derived from the use of margin models.[189] Additionally, the Commission is proposing to add Rule 17Ad-22(a)(17) to define "sensitivity analysis" to mean an analysis that involves analyzing the sensitivity of a model to its assumptions, parameters, and inputs.[190] The Commission preliminarily understands that these terms and definitions are commonly accepted among, and employed by, market participants.[191]

The Commission is also proposing to add Rule 17Ad-22(a)(6) to define "conforming sensitivity analysis" to mean a sensitivity analysis that considers the impact on the model of both moderate and extreme changes in a wide range of inputs, parameters, and assumptions, including correlations of price movements or returns if relevant, which reflect a variety of historical and

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189 See proposed Rule 17Ad-22(a)(1), infra Part VII.

190 See proposed Rule 17Ad-22(a)(17), infra Part VII.

191 See, e.g., Alexander J. McNeil, Rüdiger Frey & Paul Embrechts, Quantitative Risk Management: Concepts, Techniques, and Tools, at 35 (Princeton Univ. Press, 2005) (defining "factor-sensitivity measures" as a change in portfolio value given a predetermined change in one of the underlying risk factors).

hypothetical market conditions and actual and hypothetical portfolios of proprietary positions and, where applicable, customer positions. The Commission notes that "sensitivity analysis" is a commonly understood term among industry participants,[192] and the Commission intends for the proposed definition to ensure that the specified minimum requirements are met in performing sensitivity analyses. Under the proposed definition, a conforming sensitivity analysis, when performed by or on behalf of a covered clearing agency involved in activities with a more complex risk profile, would consider the most volatile relevant periods, where practical, that have been experienced by the markets served by the clearing agency. Under the proposed definition, a conforming sensitivity analysis would also test the sensitivity of the model to stressed market conditions, including the market conditions that may ensue after the default of a member and other extreme but plausible conditions as defined in a covered clearing agency's risk policies.[193]

Under proposed Rule 17Ad-22(e)(6)(vi), the policies and procedures for model review, testing, and verification requirements would include policies and procedures for conducting a conforming sensitivity analysis more frequently than monthly when the products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by participants increases or decreases significantly.[194] The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to report the results of such conforming sensitivity analysis to appropriate decision makers at the covered clearing agency, including its risk

192 See id.

193 See proposed Rule 17Ad-22(a)(6), infra Part VII.

194 See proposed Rule 17Ad-22(e)(6)(vi), infra Part VII.

management committee or board of directors, and use these results to evaluate the adequacy of and adjust its margin methodology, model parameters, and any other relevant aspects of its credit risk management policies and procedures. The Commission preliminary believes that the requirement to report to appropriate decision makers at the covered clearing agency, including its risk management committee or board of directors, is important to ensure that such risk management requirements and compliance therewith are addressed at the most senior levels of the governance framework of the covered clearing agency, commensurate with the importance of said requirements.

By proposing the requirement for conducting a conforming sensitivity analysis, the Commission expects that feedback generated by these analyses would improve the performance of risk-based margin systems used by covered clearing agencies and therefore better ensure the safe functioning of covered clearing agencies. Additionally, the Commission preliminarily believes that conforming sensitivity analysis may help a covered clearing agency discover and address shortcomings in its margin models that would not otherwise be revealed through backtesting and is accordingly appropriate given the risks that its size, operation, and importance pose to the U.S. securities markets.[195]

vii. Annual Conforming Model Validation

Rule 17Ad-22(b)(4) currently requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for an annual model validation consisting of evaluating the performance of the clearing agency's margin models and the related parameters and assumptions associated with such models by a qualified person who is free from influence from the persons

[195] Cf. PFMI Report, supra note 1, at 56 (discussing Principle 6, margin).

responsible for the development or operation of the models being validated. Under proposed Rule 17Ad-22(e)(6)(vii), a covered clearing agency that provides CCP services would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to require not less than annually a conforming model validation of the covered clearing agency's margin system and related models.[196] As previously discussed, the model validation would be required to include initial margin models, liquidity risk models, and models used to generate clearing or guaranty fund requirements. Also, for a model validation to be considered a conforming model validation under the proposed rule, it would have to be performed by a qualified person who is free from influence from the persons responsible for the development or operation of the models or policies being validated.[197]

The Commission preliminarily believes the proposed approach of requiring policies and procedures that subject a covered clearing agency's models to review by such parties would be relevant to ensuring the safe operation of covered clearing agencies and will help to ensure that covered clearing agencies have the opportunity to benefit from the views of a qualified person free from influence and incorporate alternative risk management methodologies into their models as appropriate. The Commission preliminarily believes this is important for covered clearing agencies given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets.

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196 See proposed Rule 17Ad-22(e)(6)(vii), infra Part VII; see also supra Part II.B.4.c.iv and infra Part VII (defining "conforming model validation" under proposed Rule 17Ad-22(a)(5) and providing the definition text, respectively).

197 See supra Part II.B.4.c.iv (describing a person who is free from influence in the context of the policy and procedure requirement for an annual conforming model validation addressing credit risk).

f. Proposed Rule 17Ad-22(e)(7): Liquidity Risk

Proposed Rule 17Ad-22(e)(7) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by it, by meeting, at a minimum, the ten requirements specified below.[198]

Liquidity risk describes the risk that an entity will be unable to meet financial obligations on time due to an inability to deliver funds or securities in the form required though it may possess sufficient financial resources in other forms. Although Rule 17Ad-22(d)(11) currently requires, among other things, that a registered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to take timely action to contain liquidity pressures and to continue to meet obligations in the event of a participant default, the Commission does not currently have requirements for policies and procedures of registered clearing agencies regarding the management of liquidity risk with the level of specificity proposed in Rule 17Ad-22(e)(7). Given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets, the proposed requirements would require a covered clearing agency to maintain sufficient liquidity resources to ensure they are prepared to meet their payment obligations in order to facilitate the prompt and accurate clearance and settlement of securities transactions.

i. Sufficient Liquid Resources

Proposed Rule 17Ad-22(e)(7)(i) would require that a covered clearing agency's policies and procedures be reasonably designed to ensure that it maintains sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday

198 See proposed Rule 17Ad-22(e)(7), infra Part VII; see also infra Parts II.B.4.f.i–x.

settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that includes the default of the participant family that would generate the largest aggregate payment obligation for it in extreme but plausible market conditions. As noted above, maintaining sufficient liquidity resources helps ensure that a covered clearing agency is prepared to meet its payment obligations in order to facilitate the prompt and accurate clearance and settlement of securities transactions

ii. Qualifying Liquid Resources

Proposed Rule 17Ad-22(e)(7)(ii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it holds qualifying liquid resources sufficient to meet the minimum liquidity resource requirement in each relevant currency for which the covered clearing agency has payment obligations owed to clearing members.[199] The Commission is also proposing to add Rule 17Ad-22(a)(15) to define "qualifying liquid resources."[200] For any covered clearing agency, in each relevant currency, qualifying liquid resources would include three types of assets:

- cash held either at the central bank of issue or at creditworthy commercial banks;[201]

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199 See proposed Rule 17Ad-22(e)(7)(ii), infra Part VII. In other words, if payment obligations were denominated in U.S. dollars, the minimum liquidity resource requirement would refer to a U.S. dollar amount.

200 See proposed Rule 17Ad-22(a)(15), infra Part VII.

201 The Commission preliminarily believes that the creditworthiness of commercial banks should be considered by a covered clearing agency after considering its particular circumstances and those of its members and the markets which it services. Accordingly, in complying with the requirements of proposed Rule 17Ad-22(e)(7) and proposed Rule 17Ad-22(a)(15), a covered clearing agency's policies and procedures for determining whether a commercial bank is creditworthy may reflect such circumstances.

- assets that are readily available and convertible into cash through either:
  - o prearranged funding arrangements without material adverse change limitations, such as committed lines of credit, foreign exchange swaps, and repurchase agreements; or
  - o other prearranged funding arrangements determined to be highly reliable even in extreme but plausible market conditions by the board of directors of the covered clearing agency following a review conducted for this purpose not less than annually; and
- other assets that are readily available and eligible for pledging to (or conducting other appropriate forms of transactions with) a relevant central bank, if the covered clearing agency has access to routine credit at such central bank.[202]

The Commission preliminarily believes that this requirement is appropriate, given the risks that its size, operation, and importance pose to the U.S. securities markets, and will help ensure that a covered clearing agency has sufficient liquid resources, as determined by stress testing, to effect settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios.[203] Furthermore, the Commission preliminarily believes this requirement is appropriate given the specific circumstances of the U.S. securities markets.

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202 See id. The Commission notes that such access to routine credit at a relevant central bank and the collateral required by such central bank to be posted to secure a loan may be determined at the discretion of the central bank, and accordingly the practical application of the definition of qualifying liquid resources would be subject to variation based on those decisions. The Commission preliminarily believes that inclusion of assets eligible for pledging to any central bank, as opposed to only to a Federal Reserve Bank, is appropriate because, in practice, a covered clearing agency may need access to liquid resources in currencies other than U.S. dollars.

203 Cf. PFMI Report, supra note 1, at 60 (discussing Principle 7, liquidity risk).

U.S. securities markets are among the largest and most liquid in the world, and CCPs operating in the United States are also among the largest in the world.[204] The resulting peak liquidity demands of CCPs are therefore proportionately large on both an individual and an aggregate basis, and the ability of CCPs to satisfy a requirement limiting qualifying liquid resources to committed facilities could be constrained by the capacity of traditional liquidity sources in the U.S. banking sector in certain circumstances. Therefore, the Commission is proposing to include in the definition of qualifying liquid resources other prearranged funding arrangements determined to be highly reliable even in extreme but plausible market conditions.

For similar reasons, the Commission preliminarily believes it is appropriate to include in the definition of qualifying liquid resources assets that a central bank would permit a covered clearing agency to use as collateral, to the extent such covered clearing agency has access to routine credit at such central bank.[205] The Commission preliminarily notes that, although covered clearing agencies do not currently have access to routine credit at Federal Reserve Banks, potential registrants that could be determined to be covered clearing agencies in the future may be operating in a jurisdiction where access to routine credit is provided to the potential registrant by that jurisdiction's central bank.[206]

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[204] See infra notes 561–562 and accompanying text (discussing the volume of transactions processed by U.S. clearing agencies).

[205] See ICMA Eur. Repo Council, The Interconnectivity of Central and Commercial Bank Money in the Clearing and Settlement of the European Repo Market, at 10–11 (Sept. 2011) (indicating that access to central bank credit is important and may cause banks to use either central bank settlement services or cash settlement banking services of a commercial bank, depending on availability of, and the terms of, central bank credit).

[206] See Peter Allsopp, Bruce Summers & John Veale, The Evolution of Real-Time Gross Settlement: Access, Liquidity and Credit, and Pricing, at 15 (World Bank, Feb. 2009) (indicating that CCPs in the Eurozone have access to central bank settlement account services and routine credit).

With regard to assets convertible into cash, the Commission preliminarily notes that the mere ownership of assets that a covered clearing agency may consider readily available and also may consider readily convertible into cash, based on factors such as the historical volume of trading in a particular market for such asset, may not be sufficient alone to make the assets count towards qualifying liquid resources unless one of the above-referenced prearranged funding arrangements is in place under which the covered clearing agency would receive cash in a timely manner. The prearranged funding arrangements would be in place to cover any shortfall. The Commission, however, preliminarily considers committed funding arrangements to be reasonably capable of being established by covered clearing agencies in the relevant commercial lending markets and other funding arrangements to be reasonably capable of being assessed for reliability by the boards of directors of covered clearing agencies following consideration of the relevant circumstances, and therefore preliminarily believes the standard to be sufficiently clear to allow for it to be interpreted and applied in practice by covered clearing agencies. Further, the Commission preliminarily notes that, in complying with proposed Rule 17Ad-22(e)(7), covered clearing agencies should consider the lower of the value of the assets capable of being pledged and the amount of the commitment (or the equivalent availability under a highly reliable prearranged facility) as the amount that counts towards qualifying liquid resources in the event there is any expected difference between the two.[207] This may occur, for example, where the

[207] The Commission notes that, based on the types of assets that may be considered qualifying liquid resources, for purposes of complying with proposed Rule 17Ad-22(e)(7)(ii), factors that may be relevant for a covered clearing agency to take into account include (i) the portion of its default fund that is held as cash, (ii) the portion of its default fund that is held as securities, (iii) the portion of any excess default fund contributions held as cash that could be used by the covered clearing agency to meet liquidity needs, (iv) the portion of any excess default fund contributions held as securities that could be used by the covered clearing agency to meet liquidity needs, (v) the amount at any given time of securities or cash delivered by

terms of the arrangement provide for over-collateralization or where the covered clearing agency lacks sufficient qualifying assets to make full use of an otherwise qualifying liquidity facility.

In defining the proposed requirements for qualifying liquid resources, the Commission preliminarily believes that it would be appropriate to provide covered clearing agencies with the flexibility to use highly reliable funding arrangements in addition to committed arrangements for purposes of using assets other than cash to meet the proposed requirements of Rule 17Ad-22(e)(7).[208] The Commission preliminarily believes that limiting the funding arrangements that are included within the definition of qualifying liquid resources to committed funding arrangements may not be necessary or appropriate in determining liquidity requirements for a covered clearing agency operating in the U.S. securities markets and expanding the concept of qualifying liquid resources to include other highly reliable funding arrangements is necessary and appropriate to ensure the proper functioning of covered clearing agencies as required by the Exchange Act.

For similar reasons, the Commission preliminarily believes it is appropriate to include in the definition of qualifying liquid resources assets that a central bank would permit a covered clearing agency to use as collateral.[209] The Commission notes that, although routine discount window borrowing at a Federal Reserve Bank is currently not available to covered clearing

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members that a covered clearing agency may be able to use to meet liquidity needs upon the default of a member, and (vi) the borrowing limits under any committed funding arrangement.

208 Cf. PFMI Report, supra note 1, at 57 (discussing Principle 7, liquidity risk, at Key Consideration 5).

209 The Commission also preliminarily notes that the term "central bank" in the proposed definition of "qualifying liquid resources" is not limited to a Federal Reserve Bank, and accordingly covered clearing agencies based in or operating outside of the United States that have access to routine credit at other central banks would be able to take that into consideration when assessing the amount of their qualifying liquid resources.

agencies, this provision will provide covered clearing agencies with additional flexibility in meeting the liquidity requirements of proposed Rule 17Ad-22(e)(7), should routine credit at a Federal Reserve Bank become available in the future.[210]

iii. Access to Account Services at a Federal Reserve Bank or Other Relevant Central Bank

Proposed Rule 17Ad-22(e)(7)(iii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it uses accounts and services at a Federal Reserve Bank, pursuant to Section 806(a) of the Clearing Supervision Act,[211] or other relevant central bank, when available and where determined to be practical by the board of directors of the covered clearing agency, in order to enhance its management of liquidity risk.[212] The Commission notes that the proposed rule would not require using Federal Reserve Bank or other relevant central bank account services; it would only require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to consider and determine when and in what circumstances it chooses to do so, when the services are available and when considered to be practical. The Commission preliminarily believes that covered clearing agencies should be encouraged to actively consider using Federal Reserve Bank or other central bank accounts and services, as this is a valuable new tool made available under the Clearing Supervision Act.[213]

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210 See infra Part IV.C.3.a.iv(4) (discussing the relative cost of central bank credit). Section 806(b) of the Clearing Supervision Act states that the Board may authorize a Federal Reserve Bank to provide to a designated FMU discount and borrowing privileges only in unusual and exigent circumstances, subject to certain conditions. See 12 U.S.C. 5465(b).

211 See 12 U.S.C. 5465(a).

212 See proposed Rule 17Ad-22(e)(7)(iii), infra Part VII.

213 See Clearing Agency Standards Release, supra note 5, at 66268–69 & n.535.

The Commission preliminarily believes, however, that it should also permit the use of commercial banks by covered clearing agencies holding cash as collateral or for other services related to clearance and settlement activity, even when comparable services are available from a central bank.

iv. Liquidity Providers

Proposed Rule 17Ad-22(e)(7)(iv) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it undertakes due diligence to confirm that it has a reasonable basis to believe each of its liquidity providers, whether or not such liquidity provider is a clearing member, has sufficient information to understand and manage the liquidity provider's liquidity risks, and the capacity to perform as required under its commitments to provide liquidity.[214]

The Commission preliminarily intends for the term "due diligence" to have the same meaning as what this term is commonly understood to mean by market participants. Consequently, in order to comply with the requirements of proposed Rule 17Ad-22(e)(7) and to form a reasonable basis regarding a liquidity provider's understanding and management of liquidity risks and operational capacity, the Commission expects a covered clearing agency would ordinarily not rely on representations of the liquidity provider to this effect and instead conduct its own investigation into the liquidity provider's business. A covered clearing agency should consider implementing due diligence procedures that provide a sufficient basis for its belief, given its business and the nature of its liquidity providers. Procedures for purposes of forming a reasonable basis could include, for example, interviewing the liquidity provider's staff and reviewing both public and non-public documents that would allow the covered clearing

[214] See proposed Rule 17Ad-22(e)(7)(iv), infra Part VII.

agency to gather information about relevant factors, including but not limited to the strength of the liquidity provider's financial condition, its risk management capabilities, and its internal controls.

The Commission preliminarily believes that proposed Rule 17Ad-22(e)(7)(iv) is appropriate because a covered clearing agency needs to soundly manage its relationships with liquidity providers given the risks posed to the U.S. securities markets by its size, operation, and importance. In addition, Proposed Rule 17Ad-22(e)(7)(iv) would reinforce proposed Rule 17Ad-22(e)(7)(ii) and the definition of qualifying liquid resources in proposed Rule 17Ad-22(a)(15), which contemplate potential reliance on liquidity providers where a covered clearing agency would seek to use assets other than cash for purposes of complying with proposed Rule 17Ad-22(e)(7)(ii) and would need to transact with a liquidity provider to convert such assets into cash. Should a committed or prearranged funding arrangement prove to be unreliable at the time a covered clearing agency needs to utilize it because of liquidity problems at the lender itself, this failure may trigger a liquidity problem at the covered clearing agency, which would raise systemic risk concerns for the U.S. securities markets. These types of problems at a liquidity provider, by indirectly affecting a covered clearing agency, could undermine the national system for the prompt and accurate clearance and settlement of securities transactions.

v. Maintenance and Annual Testing of Liquidity Provider Procedures and Operational Capacity

Proposed Rule 17Ad-22(e)(7)(v) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that the covered clearing agency maintains and, on at least an annual basis,[215] tests with each

[215] The Commission preliminary believes that an annual cycle is appropriate for the reasons described in Part II.A.3.

liquidity provider, to the extent practicable, its procedures and operational capacity for accessing each type of relevant liquidity resource.[216]

In addition, proposed Rule 17Ad-22(e)(7)(v) would reinforce proposed Rule 17Ad-22(e)(7)(ii) and the definition of qualifying liquid resources in proposed Rule 17Ad-22(a)(15), which contemplate potential reliance on liquidity providers where a covered clearing agency would seek to use assets other than cash for purposes of complying with proposed Rule 17Ad-22(e)(7)(ii) and would need to transact with a liquidity provider to convert such assets into cash. If procedures or operational capacity for accessing liquidity under committed or prearranged funding arrangements fail to function as planned and in a timely manner, the covered clearing agency may fail to meet its payment obligation, which would raise systemic risk concerns for the U.S. markets and could undermine the national system for the prompt and accurate clearance and settlement of securities transactions. Proper preparation for a liquidity shortfall scenario could also promote members' confidence in the ability of a covered clearing agency to perform its obligations, which can mitigate the risk of contagion during stressed market conditions. The Commission preliminarily believes this is important for covered clearing agencies given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets.

The Commission preliminarily believes that testing of access to liquidity resources could include efforts by a covered clearing agency to verify that a liquidity provider is able to provide the relevant liquidity resource in the manner intended under the terms of the funding arrangement and without undue delay, such as, for example, promptly funding a draw on the covered clearing agency's credit facility. Testing procedures could include, for example, test

216 See proposed Rule 17Ad-22(e)(7)(v), infra Part VII.

draws funded by the liquidity provider or tests of electronic connectivity between the covered clearing agency and the liquidity provider. The Commission recognizes that testing with liquidity providers may not always be practicable in the absence of committed liquidity arrangements.

The Commission preliminarily believes the proposed requirement that testing of a covered clearing agency's access to liquidity be conducted at least annually with each liquidity provider to be a reasonable step to ensure the objectives of the Exchange Act are achieved in practice. The Commission understands such tests are routinely performed currently by certain registered clearing agencies but are subject to variation due, in part, to the absence of a regulatory requirement and the incremental time and attention needed to conduct the tests. The Commission preliminarily anticipates the effect of the proposed rule will be to require the development of more uniform liquidity testing practices by covered clearing agencies, and has accordingly proposed to allow covered clearing agencies to assess the practicability of such testing to provide them with reasonable flexibility to design the tests to suit the circumstances of the covered clearing agency and its particular liquidity arrangements.

vi. Testing the Sufficiency of Liquid Resources

Proposed Rule 17Ad-22(e)(7)(vi)(A) through (C) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to determine the amount and regularly test the sufficiency of the liquid resources held for purposes of meeting the minimum liquid resource requirement of proposed Rule 17Ad-22(e)(7)(i) by (A) conducting a stress test of its liquidity resources at least once each day using standard and predetermined parameters and assumptions;[217] (B) conducting a comprehensive analysis of the existing stress testing scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources, and considering modifications to ensure they are appropriate for determining the covered clearing agency's identified liquidity needs and resources in light of current and evolving market conditions at least once each month;[218] and (C) conducting a comprehensive analysis of the existing stress testing scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources more frequently when products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by participants increases significantly, or in other circumstances described in the covered clearing agency's policies and procedures.[219] Proposed Rule 17Ad-22(e)(7)(vi)(D) would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to result in reporting the results of the analyses performed under proposed Rule 17Ad-22(e)(7)(vi)(B) and (C) to appropriate decision makers, including the risk management committee or board of directors, at the covered clearing agency for use in evaluating the adequacy of and adjusting its liquidity risk management framework.

The Commission preliminarily believes that proposed Rules 17Ad-22(e)(7)(vi)(A) through (D) would require a covered clearing agency to take reasonable steps to ensure the adequacy of liquid resources in practice. Given the risks that a covered clearing agency's size,

217 The Commission preliminary believes that a daily cycle is appropriate for the reasons described in Part II.A.3.

218 The Commission preliminary believes that a monthly cycle is appropriate for the reasons described in Part II.A.3.

219 See proposed Rule 17Ad-22(e)(7)(vi), infra Part VII.

operation, and importance pose to the U.S. securities markets, in addition to the potential consequences to the U.S. financial system of a failure of a covered clearing agency, the Commission preliminarily believes that requiring a covered clearing agency to devote additional time and attention to testing the sufficiency of its liquid resources, relative to a registered clearing agency generally, is appropriate. The Commission preliminarily believes that the requirements in proposed Rule 17Ad-22(e)(7)(vi) are appropriate for testing the sufficiency of liquid resources of covered clearing agencies because, in certain market conditions, such as periods of high volatility or diminished liquidity, existing stress scenarios, models, or underlying parameters may no longer be valid or appropriate. For example, covered clearing agencies may have adjusted their financial resources models following the 2008 financial crisis to account for larger debt, equity, and credit market shocks than would have been contemplated by those models prior to the crisis. Accordingly, the Commission preliminarily believes that specific policies and procedures specifying actions to be taken by covered clearing agencies to maintain sufficient liquid resources would contribute to the safe functioning of the covered clearing agency as required by the Exchange Act,[220] and that requiring periodic feedback and analysis on the strength of liquidity risk management policies and procedures would improve the reliability of those policies and procedures. The Commission also preliminarily believes that covered clearing agencies should have the flexibility to use stress scenarios that are appropriately calibrated to the markets in which they operate and that they can be revised over time as those markets change. Proper preparation for a liquidity shortfall scenario could also promote a

220 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

participant's confidence in the ability of a covered clearing agency to perform its obligations, which can mitigate the risk of undue disruption during stressed market conditions.

One of the appropriate methods of preparation by a covered clearing agency would be, in the Commission's preliminary view, the testing of the sufficiency of liquidity that it might need under certain extreme but plausible parameters and assumptions. The Commission preliminarily believes that conducting stress testing of liquidity would allow a covered clearing agency to understand its level of resilience and adjust its operations accordingly to address areas of inadequacy. The Commission preliminarily believes that by testing under extreme but plausible scenarios, covered clearing agencies, and in particular those designated systemically important, would be better prepared in the event that equivalent or similar scenarios actually occurred.

vii. Annual Conforming Model Validation

Proposed Rule 17Ad-22(e)(7)(vii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to result in performing an annual or more frequent conforming model validation of its liquidity risk models.[221]

The Commission preliminarily believes that such annual conforming model validation would provide feedback on the performance of such liquidity risk models conducted by a qualified person who is free from influence from the persons responsible for the development or operation of the liquidity risk model, as contemplated by the definition of "conforming model

221 See proposed Rules 17Ad-22(a)(5) and (e)(7)(vii), infra Part VII. The Commission notes that, in contrast to proposed Rules 17Ad-22(a)(5) and (e)(7)(vii), Rule 17Ad-22(b)(4) requires only a model validation for margin models and does not specify the general elements of a model validation. See supra note 167 and accompanying text.

In addition, the Commission preliminary believes that an annual cycle is appropriate for the reasons described in Part II.A.3.

validation" in proposed Rule 17Ad-22(a)(5), and incorporate alternative liquidity risk management methodologies into their models as appropriate. Generally, the Commission preliminarily considers that a person is free from influence when that person does not perform functions associated with the clearing agency's models (except as part of the annual model validation) and does not report to a person who performs these functions. Preliminarily, the Commission would not expect policies and procedures adopted pursuant to this proposed requirement to require the clearing agency to detach model review from model development or to maintain two separate quantitative teams. By reacting to such feedback, a covered clearing agency may improve the functioning of its liquidity risk model. The Commission notes that misspecified or miscalibrated liquidity risk models may lead to errors in decision making. The Commission preliminarily believes that the proposed rule is appropriate following consideration of the Exchange Act requirements discussed above[222] and the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets.

viii. Address Liquidity Shortfalls and Seek to Avoid Unwinding Settlement

Proposed Rule 17Ad-22(e)(7)(viii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to address foreseeable liquidity shortfalls that would not be covered by its liquid resources and seek to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations.[223] The Commission preliminarily believes advance planning by a covered clearing agency with regard

222 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

223 See proposed Rule 17Ad-22(e)(7)(viii), infra Part VII.

to liquidity shortfalls could further enhance the covered clearing agency's ability to perform its payment obligations without delay and therefore support the ability of the clearing agency's participants to function without disruption. Foreseeable liquidity shortfalls could include, for example, potential shortfalls that can be identified through testing a covered clearing agency's financial resources in a manner consistent with the policies and procedures requirements in proposed Rule 17Ad-22(e)(7)(vi). The Commission recognizes that foreseeable liquidity shortfalls could occur even when a covered clearing agency is in compliance with the proposed requirements of Rule 17Ad-22(e)(7), such as when, for example, the covered clearing agency is unable to obtain liquidity pursuant to a prearranged funding arrangements that are uncommitted. The Commission preliminarily believes the proposed requirement is appropriate for covered clearing agencies given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets and are consistent with the Exchange Act requirements discussed above.[224]

ix. Replenishment of Liquid Resources

Proposed Rule 17Ad-22(e)(7)(ix) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to describe its process for replenishing any liquid resources that it may employ during a stress event.[225] The Commission preliminarily believes a covered clearing agency should specifically contemplate and memorialize its expectations for replenishing its financial resources when they are depleted so that its ability to withstand repeated stress events, such as multiple market shocks or

224 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

225 See proposed Rule 17Ad-22(e)(7)(ix), infra Part VII.

sequential defaults of multiple participants is clearly understood and reflected in its planning for such events. The Commission preliminarily believes that the proposed requirement is appropriate given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets and is consistent with the Exchange Act requirements discussed above.[226]

x. Feasibility Analysis for "Cover Two"

Proposed Rule 17Ad-22(e)(7)(x) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it, at least once a year, evaluates the feasibility of maintaining sufficient liquid resources at a minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions if the covered clearing agency provides CCP services and is either systemically important in multiple jurisdictions or a clearing agency involved in activities with a more complex risk profile.[227]

Rule 17Ad-22 does not currently provide specific requirements regarding the sizing and testing of liquid resources or what types of financial resources would qualify as liquid. However, the financial crisis of 2008 demonstrated the plausibility of the default of two large

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226 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

227 See proposed Rule 17Ad-22(e)(7)(x), infra Part VII.

participants in a clearing agency over a brief period.[228] Accordingly, the Commission preliminarily believes that its proposed approach is appropriate, given the need for more stringent financial resource requirements for a covered clearing agency due to the risks that its size, operation, and importance pose to the U.S. securities markets, and is consistent with the Exchange Act requirements discussed above.[229] The Commission also believes that such financial resources must be robust enough to accommodate the risks that are particular to each market served and accordingly believes that a covered clearing agency should have the flexibility to determine that different standards are appropriate in different markets, given the variable nature and risks associated with the products cleared.[230]

The Commission also preliminarily believes that, with greater emphasis being placed on the role of CCPs in the financial system, the requirement in proposed Rule 17Ad-22(e)(7)(x) for CCPs to review and consider the feasibility of meeting a higher liquidity risk management standard is appropriate. While Rule 17Ad-22(e)(7)(x) would impose on certain covered clearing agencies' policies and procedures requirements to conduct an annual analysis of the feasibility of maintaining "cover two" for liquidity, such covered clearing agencies would not be mandated to adopt a "cover two" approach regarding liquidity risk management. The responsibility for such a

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228 See Clearing Agency Standards Release, supra note 5, at 66235–36 (noting that the financial crisis of 2008 demonstrated the plausibility of the default of two large participants in a clearing agency over a brief period).

229 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

230 See generally Clearing Agency Standards Release, supra note 5, at 66234–36 (describing a "cover two" requirement for credit risk).

determination would remain with the boards of directors of covered clearing agencies following a review of the information produced pursuant to proposed Rule 17Ad-22(e)(7)(x).

The Commission preliminarily believes that it may be appropriate for a covered clearing agency that provides CCP services to maintain liquidity coverage at levels higher than other clearing agencies due to the heightened need to ensure the safe operation of covered clearing agencies given their importance to the U.S. financial markets and the risks attributable to the products they clear, but also that covered clearing agencies not subject to a "cover two" requirement should have flexibility to evaluate the results of an annual feasibility study and to make their own determinations as to whether a "cover two" approach to liquidity risk management is necessary or appropriate. Furthermore, the Commission notes that if, following completion of a feasibility study as contemplated in proposed Rule 17Ad-22(e)(7)(x), a covered clearing agency makes a determination to move beyond "cover one" for liquidity that would be required under proposed Rule 17Ad-22(e)(7)(i), such covered clearing agency would not be limited to sizing its qualifying liquid resources to cover the default of its two largest participant families. In such case, the covered clearing agency could select a level of liquid resources exceeding "cover one" that it deems most appropriate to the management of liquidity risk, which could be either less than, equal to, or more than "cover two."

Based on its supervisory experience, the Commission also preliminarily believes that, in sizing its liquid resources to exceed "cover one," a covered clearing agency may take into account a variety of factors, including, but not limited to, (i) the business model of the covered clearing agency, such as a utility model (which may be also referred to as an "at cost" model) versus a for-profit model; (ii) diversification of its members' business models as they impact the members' ability to supply liquidity to the covered clearing agency; (iii) concentration of membership of the covered clearing agency, as the breadth of the membership may affect the ability to draw liquidity from members; (iv) levels of usage of the covered clearing agency's services by members, as the concentration of demand on the covered clearing agency's services may bear upon potential liquidity needs; (v) the relative concentration of members' market share in the cleared products; (vi) the degree of alignment of interest between member ownership of the covered clearing agency and the provision of funding to the covered clearing agency; and (vii) the nature of, and risks associated with, the products cleared by the covered clearing agency.

g. Request for Comments

The Commission generally requests comments on all aspects of proposed Rules 17Ad-22(e)(4), (5), (6), and (7) and proposed Rules 17Ad-22(a)(5), (6), (14), (15), (17), (18), and (19). In particular, the Commission requests comments on the following issues:

- Has the Commission provided sufficient guidance for Rule 17Ad-22(e)(4) regarding the meaning of the requirement to cover credit exposures to each participant "fully with a high degree of confidence"? Has the Commission provided sufficient guidance regarding the meaning of the requirement to maintain the financial resources required under proposed Rules 17Ad-22(e)(4)(i) through (iii), as applicable, "in combined or separately maintained clearing or guaranty funds"? Has the Commission provided sufficient guidance regarding the use of "high volatility" and "become less liquid"? Why or why not?
- Is the Commission's proposed requirement to cover credit exposures to each participant "fully with a high degree of confidence" in proposed Rule 17Ad-22(e)(4) appropriate? Why or why not?

- Should a covered clearing agency's policies and procedures provide for the measurement of credit exposures more frequently than once per day? Why or why not? If so, how frequently? What factors should be considered in determining the minimum frequency?
- Should the Commission require a covered clearing agency's policies and procedures to limit the assets it accepts as collateral to those with low credit, liquidity, and market risks? Why or why not? Has the Commission provided sufficient guidance regarding what constitutes "low credit, liquidity, and market risks"? Why or why not? If not, what additional guidance should the Commission consider providing?
- Should the Commission require a covered clearing agency's policies and procedures to set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its or its participants' credit exposure? Why or why not? Has the Commission provided sufficient guidance on what would constitute "appropriately conservative haircuts and concentration limits"? Why or why not? Should the Commission adopt different standards? If so, what should those standards be? Please explain in detail.
- Are there any other requirements that should be included in proposed Rule 17Ad-22(e)(5) to facilitate policies and procedures that address collateral? Why or why not? Are there any requirements that should be removed? Why or why not? For instance, should the Commission require policies and procedures that avoid concentrated holdings of any particular kind of asset, such as those that would significantly impair the covered clearing agency's ability to liquidate such assets quickly without significant adverse price effects? Should the Commission require policies and procedures that avoid concentrated holdings under certain conditions?

- Has the Commission provided sufficient guidance for Rule 17Ad-22(e)(6) regarding "margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market"? Has the Commission provided sufficient guidance regarding what a "reliable" source of timely price data is? Why or why not? Should the Commission use a different standard? If so, what should that standard be? Please explain in detail.
- Is the requirement in proposed Rule 17Ad-22(e)(6)(i) regarding policies and procedures reasonably designed to result in a margin system that at a minimum considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market appropriate? Why or why not?
- Is the Commission's approach in proposed Rule 17Ad-22(e)(6)(iii), requiring a covered clearing agency's policies and procedures to calculate margin sufficient to cover its potential future exposure to participants, and the definition of "potential future exposure" in proposed Rule 17Ad-22(a)(14) to mean the "maximum exposure estimated to occur at a future point in time with an established single-tailed confidence interval of at least 99% with respect to the estimated distribution of future exposure" appropriate and sufficiently clear? Why or why not?
- Are there any other requirements that should be included in proposed Rule 17Ad-22(e)(6) to facilitate policies and procedures that address margin? Why or why not? For instance, should the Commission require policies and procedures that address minimum liquidation periods for products cleared by covered clearing agencies? Why or why not?
- Has the Commission provided sufficient guidance for Rule 17Ad-22(e)(7) regarding what constitutes the "relevant currency" in holding qualifying liquid resources? Has the

Commission provided sufficient guidance regarding the "due diligence" with respect to liquidity providers? Has the Commission provided sufficient guidance regarding what constitutes "foreseeable" liquidity shortfalls? Why or why not?

- Has the Commission provided sufficient guidance regarding what constitutes "regularly" testing the sufficiency of liquid resources under proposed Rule 17Ad-22(e)(7)(vi)? Why or why not? How frequently should a covered clearing agency test the sufficiency of its liquid resources? Please explain.
- Does the set of minimum requirements for policies and procedures under proposed Rule 17Ad-22(e)(7) sufficiently address liquidity risks? Why or why not? Should the Commission adopt other requirements for addressing liquidity risk?
- Is the proposed definition of "qualifying liquid resources" under Rule 17Ad-22(a)(15) accurate, appropriate, and sufficiently clear given the requirements proposed? Why or why not? Should all types of assets be subject to prearranged funding arrangements? Should the proposed definition distinguish among them by asset, product type, or liquidity? Are there alternative definitions the Commission should consider?
- Is the meaning of the term "due diligence" under Rule 17Ad-22(7)(iv) sufficiently clear? Why or why not?
- Is the proposed definition of "systemically important in multiple jurisdictions" under Rule 17Ad-22(a)(19) accurate, appropriate, and sufficiently clear given the requirements proposed? Why or why not? Are there alternative definitions the Commission should consider? How should the Commission assess another regulator or jurisdiction's

determination that a covered clearing agency is systemically important in multiple jurisdictions? Please explain.[231]

- Is the Commission's proposed approach to "cover one" and "cover two" with respect to credit risk appropriate? Should the Commission expand or contract the scope of covered clearing agencies subject to a "cover two" requirement beyond those systemically important in multiple jurisdictions or those involved in activities with a more complex risk profile? Why or why not? Is the "cover two" approach, in which the covered clearing agency must have policies and procedures requiring financial resources sufficient to cover the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions, appropriate? Should the Commission require policies and procedures that provide for financial resources in excess of "cover two"? Why or why not? If so, what would be the potential costs and benefits?
- Is the Commission's proposed approach to "cover one" and "cover two" with respect to liquidity risk appropriate? Should the Commission require policies and procedures that would provide for maintaining qualifying liquid resources equal to "cover two," rather than policies and procedures for a feasibility analysis with regard to "cover two"? Why or why not?
- Should the Commission include more specific requirements for policies and procedures regarding stress testing that take into account, for example, relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves,

231 For additional requests for comments relating to proposed Commission determinations under Rule 17Ab2-2, see Part II.C.4.

multiple defaults over various time horizons, simultaneous pressures in funding and asset markets, or a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions? Why or why not?

- Is the requirement to require policies and procedures for reporting the results of a conforming sensitivity analysis to the appropriate decision makers at the covered clearing agency appropriate? Why or why not? Has the Commission sufficiently described who the appropriate decision makers are? Please explain.
- Do any of the proposed rules for financial risk management differentiate between clearing agencies based on factors that should not be determinative, i.e. whether a clearing agency is covered or uncovered, whether a clearing agency is systemically important in multiple jurisdictions, involved in activities with a more complex risk profile, or neither, and whether the clearing agency provides CCP services for security-based swaps or other securities? Should the Commission consider other factors in determining which clearing agencies should be subject to the proposed requirements?

5. Proposed Rule 17Ad-22(e)(8): Settlement Finality

Proposed Rule 17Ad-22(e)(8) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to define the point at which settlement is final no later than the end of the day on which the payment or obligation is due and, where necessary or appropriate, intraday or in real time.[232]

Rule 17Ad-22(d)(12) currently requires registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that final settlement occurs no later than the end of the settlement day and to require that intraday

[232] See proposed Rule 17Ad-22(e)(8), infra Part VII.

or real-time finality be provided where necessary to reduce risks.[233] The Commission preliminarily believes that defining settlement finality with specific reference to the day on which the payment or obligation is due is appropriate because it better reflects the prevailing international convention and accordingly helps to ensure that covered clearing agencies can facilitate transactions globally.[234] Because of the similarity between proposed Rule 17Ad-22(e)(8) and Rule 17Ad-22(d)(12), the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures to comply with the proposed rule.[235]

As with Rule 17Ad-22(d)(12), the Commission preliminarily believes that proposed Rule 17Ad-22(e)(8) is appropriate for covered clearing agencies, given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets, for the following reasons. First, the Commission preliminarily believes that defining the point at which settlement is final may assist in the potential wind-down of a member in the event of insolvency because it provides the covered clearing agency with information regarding the member's open positions. As an example, clearly defining the point at which settlement is final might include establishing a cut-off point after which unsettled payments, transfer instructions, or other obligations may not be revoked by a clearing member. Clearly defining the point at which settlement is final could also provide to clearing members the necessary guidance from the

233 See 17 CFR 240.17Ad-22(d)(12); see also Clearing Agency Standards Release, supra note 5, at 66255–56. Rule 17Ad-22(d)(12) focuses on achieving settlement on the particular settlement date associated with the securities transaction or on an intraday or real-time basis (i.e., delivery versus payment) where those additional steps are necessary to reduce risks. See Clearing Agency Standards Release, supra note 5, at 66256.

234 Cf. PFMI Report, supra note 1, at 64.

235 See supra Part II.A.4.

covered clearing agency to permit extensions for members with operating problems. For example, the covered clearing agency may establish rules governing the approval and duration of such extensions.

Second, the Commission preliminarily believes that a covered clearing agency's policies and procedures should require completing final settlement no later than the end of the day on which the payment or obligation is due and that practices creating material uncertainty regarding when final settlement will occur or permit the back-dating or "as of" dating of a transaction that settles after the end of the day on which the payment or obligation is due would not comply with this requirement. The Commission preliminarily believes that final settlement has the effect of reducing the buildup of exposures between clearing members and the clearing agency, and final settlement no later than the end of the day on which the payment or obligation is due limits these exposures to the change in price between valuation and the end of the day. Accordingly, deferring final settlement beyond the end of the day on which the payment or obligation is due would allow these exposures to increase in size, thereby creating the potential for credit and liquidity pressures for members and other market participants and potentially increasing systemic risk.

Third, the Commission preliminarily believes that a covered clearing agency's policies and procedures, where necessary and appropriate, should require intraday or real-time finality in order to reduce risk in circumstances where uncertainty regarding finality may impede the clearing agency's ability to facilitate prompt and accurate clearance and settlement, cause the clearing agency's members to fail to meet their obligations, or otherwise disrupt the securities markets. The Commission preliminarily believes that such efforts would be necessary and appropriate when, for example, the risks in question are material or when the opportunity to require intraday or real-time finality is available and it would be reasonable, whether in economic or other terms, to do so.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(8). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to define the point at which settlement is final no later than the end of the day on which the payment or obligation is due, as in the proposed rule, or no later than the end of the settlement date, as in existing Rule 17Ad-22(d)(12) applicable to registered clearing agencies? Please explain.
- What changes, if any, would be created by the proposed requirements for settlement finality? Does the proposed rule affect certain, identifiable categories of market participants differently than others, such as smaller entities or entities with limited operations in the United States? If so, how?
- Are there operational, legal, or regulatory impediments to intraday or real-time settlement finality? Will the proposed standard make it harder for covered clearing agencies to conduct certain types of business for which intraday or real-time finality may be difficult? Are any additional rules or regulations needed to encourage intraday or real-time finality to reduce risks?
- Are there circumstances when the requirements of intraday, real-time, or end-of-day settlement finality proposed by the rule are not feasible or are not beneficial? If so, in what circumstances?

6. Proposed Rule 17Ad-22(e)(9): Money Settlements

Proposed Rule 17Ad-22(e)(9) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it considers conducting its money settlements in central bank money, where available and determined to be practical by the board of directors of the covered clearing agency, and minimizes and manages credit and liquidity risk arising from conducting its money settlements in commercial bank money if central bank money is not used by the covered clearing agency.[236] Rule 17Ad-22(e)(9) contains requirements similar to those applied to registered clearing agencies under Rule 17Ad-22(d)(5), but would additionally require a covered clearing agencies to have policies and procedures for conducting money settlement in central bank money.[237] Because this is the only requirement that differs between proposed Rule 17Ad-22(e)(9) and existing Rule 17Ad-22(d)(5), the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures.[238]

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236 See proposed Rule 17Ad-22(e)(9), infra Part VII.

The Commission notes that, in some cases, for example, the use of central bank money may not be practical, as direct access to all central bank accounts and payment services may not be available to certain clearing agencies or members, and, for clearing agencies working under different currencies, certain central bank accounts may not be operational at the time money settlements occur.

237 In full, Rule 17Ad-22(d)(5) requires registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to employ money settlement arrangements that eliminate or strictly limit the clearing agency's settlement bank risks, such as credit and liquidity risks from the use of banks to effect money settlements with its participants. See 17 CFR 240.17Ad-22(d)(5); see also Clearing Agency Standards Release, supra note 5, at 66249–50.

238 See supra Part II.A.4 (noting the anticipated effect of the proposed rule) and infra Part IV.B.3.c (describing the current practices at registered clearing agencies regarding settlement).

As with Rule 17Ad-22(d)(5), the Commission is proposing Rule 17Ad-22(e)(9) to provide assurance that funds transfers are final when effected.[239] The Commission preliminarily believes that the proposed requirement for policies and procedures for conducting money settlement in central bank money would, in addition, help to further reduce the risk that financial obligations related to the activities of a covered clearing agency are not settled in a timely manner or discharged with finality because settlement in central bank money eliminates settlement risk within the jurisdiction of the central bank.[240]

The Commission notes that there are a number of arrangements that a covered clearing agency could employ to meet the requirements under the proposed rule. For example, pursuant to the Clearing Supervision Act, designated clearing agencies may obtain access to account services at a Federal Reserve Bank.[241] The Commission preliminarily believes, however, that it may be appropriate for covered clearing agencies to use commercial banks for conducting money settlements even when comparable services are available from a central bank, and therefore the proposed rule would permit a covered clearing agency to decide for itself which service to use in those circumstances. If central bank account services are not available or used, then the covered clearing agency should consider establishing criteria for use of commercial banks to effect money settlements with its participants that address such commercial banks' regulation and supervision, creditworthiness, capitalization, access to liquidity, and operational reliability. In

239 See proposed Rule 17Ad-22(e)(9), infra Part VII.

240 See ICMA Eu. Repo Council, supra note 205, at 8–9 (noting that central bank money "can be regarded as completely safe in the jurisdiction of the central bank" and listing a number of advantages attributable to central bank money).

241 See 12 U.S.C. 5465(a); see also supra Parts II.B.4.d and II.B.4.f.iii (discussing access to account services at a Federal Reserve Bank, or other relevant central bank, pursuant to proposed Rules 17Ad-22(e)(5) and (7), respectively).

addition, a covered clearing agency also could seek to ensure that its legal agreements with such commercial settlement banks support such risk-reduction principles and commercial settlement bank criteria, including through provisions providing that funds transfers to the covered clearing agency are final when effected.

The proposed rule would also permit a covered clearing agency to use multiple settlement banks in order to monitor and manage concentration of payments among its commercial settlement banks. In those circumstances, policies and procedures would be required to consider the degree to which concentration of a covered clearing agency's exposure to a commercial settlement bank is affected or increased by multiple relationships with the settlement bank, including (i) where the settlement bank is also a participant in the covered clearing agency, or (ii) where the settlement bank provides back-up liquidity resources to the covered clearing agency.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(9). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to conduct its money settlements in central bank money, where available and determined to be practical by the board of directors of the covered clearing agency? Why or why not? Has the Commission provided sufficient guidance on what would be "practical" in this context? Why or why not?
- Should the Commission require a covered clearing agency's policies and procedures to minimize and manage credit and liquidity risk arising from conducting its money settlements in commercial bank money if central bank money is not used by the covered clearing agency? Why or why not?

- Are there other requirements that the Commission should apply to money settlements, such as requiring policies and procedures with respect to the minimum number of banks that a covered clearing agency may use to effect money settlements with its participants in order to avoid reliance on a small number of such banks? Should the Commission require policies and procedures specifying the characteristics of financial institutions that may be used by clearing agencies for settlement purposes? Why or why not?
- Should the Commission require a covered clearing agency's policies and procedures to establish and monitor adherence to criteria based on high standards for the covered clearing agency's settlement banks? For example, should the Commission require that criteria to consider the applicable regulatory and supervisory frameworks, creditworthiness, capitalization, access to liquidity, and operational reliability? Why or why not?
- Should the Commission require a covered clearing agency's policies and procedures to monitor and manage the concentration of credit and liquidity exposures to its commercial settlement banks? Why or why not?
- Should rules for money settlements established by the Commission be uniform for all types of money settlements, or are there circumstances in which it would be appropriate for covered clearing agencies to accept a higher degree of money settlement risk, such as when transacting in certain product categories or with certain types of customers? Why or why not?

7. Proposed Rule 17Ad-22(e)(10): Physical Delivery Risks

Proposed Rule 17Ad-22(e)(10) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish and maintain transparent written standards that state its obligations with respect to the delivery of physical instruments and operational practices that identify, monitor, and manage the risk associated with such physical deliveries.[242]

The proposed requirement is similar to the requirement applicable to registered clearing agencies in Rule 17Ad-22(d)(15), but the proposed rule also requires that such standards be transparent at covered clearing agencies.[243] Considering the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets, the Commission preliminarily believes that the proposed new requirement for transparent standards is appropriate. Physical delivery may require the involvement of multiple parties, including the clearing agency itself, its members, customers, custodians, and transfer agents, and failures to deliver physical instruments can threaten the integrity and smooth functioning of the financial system. By requiring policies and procedures to include transparent written standards at covered clearing agencies, the proposed rule helps to mitigate physical delivery risks.

The Commission preliminarily believes that the proposed requirement for a covered clearing agency to maintain transparent written standards that state its obligations with respect to physical deliveries would help to ensure that members and their customers have information that is likely to enhance their understanding of their rights and responsibilities with respect to using

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242 See proposed Rule 17Ad-22(e)(10), infra Part VII.

243 Registered clearing agencies are currently subject to existing Rule 17Ad-22(d)(15), which requires them to establish, implement, maintain and enforce written policies and procedures reasonably designed to state to its participants the clearing agency's obligations with respect to physical deliveries and identify and manage the risks from these obligations. See 17 CFR 240.17Ad-22(d)(15); see also Clearing Agency Standards Release, supra note 5, at 66257–58.

the clearance and settlement services of a covered clearing agency.[244] The Commission preliminarily believes that such information, when available to members and their customers through the covered clearing agency's policies and procedures, would promote a shared understanding regarding physical delivery practices between the covered clearing agency and its members. The requirement for policies and procedures with transparent written standards may further facilitate prompt and accurate clearance and settlement and mitigate physical delivery risks.

The Commission acknowledges that practices regarding physical delivery vary based on the types of assets that a covered clearing agency settles.[245] A covered clearing agency would be required, however, to state clearly which asset classes it accepts for physical delivery and the procedures surrounding the delivery of each. The Commission notes that there are a number of arrangements that a covered clearing agency could employ pursuant to the requirements of the proposed rule. For example, if a covered clearing agency takes physical delivery of securities from its members in return for payments of cash, then it should inform its members of the extent

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244 The Commission is proposing additional requirements regarding disclosures to participants and disclosure generally, pursuant to proposed Rules 17Ad-22(e)(1) (legal risk), (e)(2) (governance), and (e)(23) (disclosure of rules, key procedures, and market data). See infra Parts II.B.1, 2, and 20, respectively.

245 The proposed rule would provide covered clearing agencies with flexibility to achieve clear and transparent standards but would necessarily require an approach that provides sufficient notice to its participants regarding the covered clearing agency's obligations. See infra Parts II.B.20 and VII (discussing a covered clearing agency's disclosure obligations pursuant to proposed Rule 17Ad-22(e)(23) and providing proposed rule text).

The Commission notes that CDS employing the contractual term "physical delivery" or similar language, which upon an event of default are settled by "physical delivery" of the instrument (as such terms are used in the agreement) to the protection seller by the protection buyer are not within the scope of this rule merely because of such contractual terminology where they are not delivered in paper form (but are delivered through book entry or electronic transfer).

of the clearing agency's obligations to make payment. The Commission envisions that one possible approach a covered clearing agency could take in fulfillment of the proposed requirement would be to employ policies and procedures that clearly state any obligations it incurs to members for losses incurred in the delivery process. In addition, its policies and procedures could clearly state rules or obligations regarding definitions for acceptable physical instruments, the location of delivery sites, rules for storage and warehouse operations, and the timing of delivery.

The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage the risks that arise in connection with their obligations for physical deliveries.[246] The Commission notes that this is similar to the requirement for a registered clearing agency's policies and procedures to identify and manage the risks from its obligations in Rule 17Ad-22(d)(15).[247] As with Rule 17Ad-22(d)(15), the Commission believes that requiring a clearing agency's policies and procedures to identify, monitor, and manage these risks facilitates its ability to deal preemptively with potential issues with physical delivery, in line with Exchange Act requirements to facilitate prompt and accurate clearance and settlement and the safeguarding of assets.[248]

The Commission preliminarily notes that certain risks associated with physical deliveries could stem from operational limitations with respect to assuring receipt of and processing of physical deliveries. Other operational risks may relate to personnel, which can be mitigated by

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246 See proposed Rule 17Ad-22(e)(10), infra Part VII.

247 See supra note 243.

248 See 15 U.S.C. 78q-1(b)(3)(F).

having policies and procedures designed to review and assess the qualifications of potential employees, including reference and background checks and employee training, among other things. Further operational risks include theft, loss, counterfeiting, and deterioration of or damage to assets.[249] Insurance coverage may be one way to mitigate such risk of theft, loss, counterfeiting, fraud, and damage to assets. Other appropriate methods to identify, monitor, and manage risks related to delivery and storage of physical assets may include ensuring records of physical assets received and held accurately reflect holdings and that employee duties for such recordkeeping for and holding of physical assets are separated.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(10). In addition, the Commission requests comments on the following specific issue:

- Should the Commission require a covered clearing agency's policies and procedures to establish and maintain transparent written standards that state its obligations with respect to the delivery of physical instruments? Why or why not? Are there physical delivery obligations that a covered clearing agency's policies and procedures should not be required to state through transparent written standards? If so, please explain.

8. Proposed Rule 17Ad-22(e)(11): Central Securities Depositories

Proposed Rule 17Ad-22(e)(11) would apply only to a covered clearing agency providing CSD services (hereinafter a "covered CSD" in this part).[250] Proposed Rule 17Ad-22(e)(11)(i)

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249 In addition, the Commission is proposing Rule 17Ad-22(e)(17) to establish minimum requirements for operational risk management. See infra Parts IV.C.3.a.xii and VII (further discussing the proposed requirements and providing proposed rule text).

250 See proposed Rule 17Ad-22(a)(3), infra Part VII (defining "central securities depository services"). In the United States, DTC is currently the only registered clearing agency that provides CSD services.

would require a covered CSD to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain securities in an immobilized or dematerialized form for their transfer by book entry, ensure the integrity of securities issues, and minimize and manage the risks associated with the safekeeping and transfer of securities.[251] While Rule 17Ad-22(d)(10) similarly requires registered clearing agencies that provide CSD services to have policies and procedures reasonably designed to immobilize or dematerialize securities certificates and transfer them by book entry to the greatest extent possible,[252] proposed Rule 17Ad-22(e)(11) would also require a covered CSD to have policies and procedures that ensure the integrity of securities issues, and minimize and manage the risks associated with the safekeeping and transfer of securities. The Commission preliminarily believes these additional requirements are appropriate for covered CSDs given the risks that a covered CSD's size, operation, and importance pose to the U.S. securities markets.

Like existing Rule 17Ad-22(d)(10), proposed Rule 17Ad-22(e)(11)(i) would, among other things, require a covered CSD to have policies and procedures to maintain securities in an immobilized or dematerialized form for transfer by book entry.[253] The Commission

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This definition is currently codified at 17 CFR 240.17Ad-22(a)(2). See supra note 61 (noting that 17 CFR 240.17Ad-22(a) is being revised to incorporate additional terms).

251 See proposed Rule 17Ad-22(e)(11), infra Part VII.

252 In full, existing Rule 17Ad-22(d)(10) requires registered clearing agencies that provide CSD services to establish, implement, maintain and enforce written policies and procedures reasonably designed to immobilize or dematerialize securities certificates and transfer them by book entry to the greatest extent possible. See 17 CFR 240.17Ad-22(d)(10); see also Clearing Agency Standards Release, supra note 5, at 66253–54.

253 Immobilization refers to any circumstance where an investor does not receive a physical certificate upon the purchase of shares or is required to physically deliver a certificate upon the sale of shares. Dematerialization is the process of eliminating physical certificates as a record of security ownership.

preliminarily believes this approach would continue to promote a reduction in securities transfer processing costs, as well as the risks associated with securities settlement and custody, such as destruction or theft, by removing the need to hold and transfer many, if not most, physical certificates.[254] In addition, the Commission preliminarily believes the requirement would continue to promote prompt and efficient settlement processes through the potential for increased automation and may also help reduce the risk of error and delays in securities processing. The Commission also preliminarily believes the proposed rule would, like Rule 17Ad-22(d)(10), further the objectives in Section 17A of the Exchange Act requiring the Commission to end the physical movement of securities certificates in connection with settlement among brokers and dealers.[255] Further, the Commission preliminarily believes that the proposed rule, by continuing to facilitate book-entry transfer, may also continue to facilitate the use of exchange-of-value

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The Commission notes that, while registered clearing agencies that provide CSD services are already subject to this requirement under Rule 17Ad-22(d)(10), the Commission is proposing Rule 17Ad-22(e)(10) as part of a comprehensive set of rules for regulating covered clearing agencies. Because Rule 17Ad-22(d)(10) already contains this requirement, however, the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures to comply with this requirement under the proposed rule. See supra Part II.A.4.

254 By concentrating the location of physical securities in a CSD, clearing agencies are able to achieve efficiencies in clearance and settlement by streamlining transfer. Virtually all mutual fund securities, government securities, options, and municipal bonds in the United States are dematerialized and most of the equity and corporate bonds in the U.S. market are either immobilized or dematerialized. While the U.S. markets have made great strides in achieving immobilization and dematerialization for institutional and broker-to-broker transactions, many industry representatives believe that the small percentage of securities held in certificated form imposes unnecessary risk and expense to the industry and to investors. See Exchange Act Release No. 34-49405 (Mar. 11, 2004), 69 FR 12922, 12933 (Mar. 18, 2004).

255 See 15 U.S.C. 78q-1(e).

settlement systems, which help to reduce settlement risk pursuant to proposed Rule 17Ad-22(e)(12).[256]

As with Rule 17Ad-22(d)(10), the Commission notes that the proposed requirement for policies and procedures to cover maintaining securities in an immobilized form is not intended to prohibit a covered CSD from holding physical securities certificates on behalf of its members for purposes other than to facilitate immobilization where such securities currently continue to exist in paper form. In this regard, the Commission believes it would be useful to describe three relevant features of the current U.S. market. First, in order for securities to be offered and sold publicly, the offer or sale of the securities generally must be registered with the Commission or subject to an exemption from registration.[257] Securities sold in an exempt transaction may be subject to restrictions. For example, securities acquired from the issuer in a transaction not involving any public offering are restricted securities,[258] are subject to restrictions on resale, often bear legends that discuss such restrictions, and often are in paper certificate form in current market practice. The restrictions on such securities may make more complex the immobilization or ultimate dematerialization of these paper certificates. For instance, registered CSDs in the United States currently do not provide book-entry transfer for all restricted securities.[259]

256 See infra Parts II.B.9 (discussing proposed Rule 17Ad-22(e)(12) for exchange-of-value settlement systems) and IV.C.3.a.vi (noting that the economic effect of book-entry transfer in a delivery versus payment system is to allow securities to be credited to an account immediately upon debiting the account for the payment amount and that it thereby helps reduce trade failures).

257 See 15 U.S.C. 77e.

258 See 17 CFR 230.144(a)(3).

259 See 17 CFR 230.144A; see also Exchange Act Release No. 34-59384 (Feb. 11, 2009), 74 FR 7941 (Feb. 20, 2009); DTC, Operational Arrangements, Secs. I.A.2 & I.B.5 (Jan. 2012), available at http://www.dtcc.com/.

Second, U.S. law generally does not provide for a federal corporate law or corporate charter. Instead, states currently permit corporations to issue stock certificates to registered owners. While the market in the United States has made advances in immobilizing and dematerializing securities, no federal statute or regulation prohibits the issuance of paper certificates to registered owners of a class of securities registered under the Exchange Act or companies that file periodic reports with the Commission. Accordingly, the Commission's rules do not prohibit, and in some respects contemplate, the issuance of securities certificates.[260] As a result, some registered owners may hold securities in paper certificate form.

Third, some broker-dealers in the United States no longer operate vaults in which to hold securities certificates registered in the names of their customers where such customers seek a third-party to physically hold their certificates. In such cases, broker-dealers (without an in-house vault) may utilize the vault services of the CSD of which they are a participant in order to be able to offer such custody service to their customers.

The Commission also notes that the proposed rule is not intended to alter the following practices in the U.S. market. Proposed Rule 17Ad-22(e)(11) would not prohibit a covered CSD from providing custody-only services for purposes not intended to promote immobilization to facilitate street name transfer but solely to hold these securities for third parties. Likewise, proposed Rule 17Ad-22(e)(11) would not prohibit a covered CSD from holding American depositary shares in custody.[261]

[260] In the absence of a federal or state requirement, an issuer could limit its issuance of certain types of securities to book-entry only form through its own charter, bylaws, or policies.

[261] Issuers of American depositary receipts ("ADRs"), whether in programs sponsored or unsponsored by a foreign issuer, may hold the underlying shares of the foreign issuer (which may be in paper certificate form and are commonly referred to as American depositary shares) to which the ADRs relate in the ultimate custody of a covered CSD.

In addition, the Commission preliminarily believes that the policies and procedures of a covered CSD should be required to ensure the integrity of securities issues and minimize and manage the risks associated with the safekeeping and transfer of securities, given the risks that a covered CSD's size, operation, and importance pose to the U.S. securities markets, for the following reasons. First, the preservation of the rights of issuers and holders of securities is necessary for the orderly functioning of the securities markets.[262] The integrity of a securities issue can be undermined, for instance, if a covered CSD does not prohibit overdrafts and debit balances in securities accounts, which can create unauthorized issuances of securities that undermine the integrity of the covered CSD's services. Second, minimizing and managing the risks associated with the safekeeping and transfer of securities promotes risk management policies and procedures that address custody risk.[263]

In addition, the Commission is proposing the requirements described below. Although Rule 17Ad-22(d)(10) does not include similar requirements, the Commission anticipates that, based on the current practices of registered CSDs in the United States, a registered CSD may need to make only limited changes to update its policies and procedures to comply with the below proposed requirements.[264]

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262 The Commission is proposing additional requirements under Rule 17Ad-22(e)(11) to further address the integrity of securities issues. See infra Part II.B.8.a.

263 The Commission is proposing additional requirements under Rule 17Ad-22(e)(11) to further address custody risk at covered CSDs. See infra Part II.B.8.c.

264 See infra Parts IV.B.3.d.i (discussing the current practices of registered CSDs in the United States) and IV.C.3.a.vi (discussing the anticipated economic effect of the proposed rule).

a. Controls to Safeguard the Rights of Securities Issuers and Holders and Prevent the Unauthorized Creation or Deletion of Securities

Proposed Rule 17Ad-22(e)(11)(ii) would require a covered CSD to establish, implement, maintain and enforce written policies and procedures reasonably designed to implement internal auditing and other controls to safeguard the rights of securities issuers and holders and prevent the unauthorized creation or deletion of securities.

The Commission preliminarily believes that the proposed requirement to safeguard the rights of issuers and holders is appropriate because, while issuers and holders may not be participants in a covered CSD, they access its services through covered CSD immobilization or dematerialization of securities and thus a failure to safeguard securities by the CSD may adversely affect issuers or holders, including for example by creating legal problems related to unauthorized issuance of securities, dilution of a holder's ownership interest or the holder's claim on the security as beneficial owner where holding indirectly through a member of the CSD.

As noted above, the preservation of the rights of securities issuers and holders is necessary for the orderly functioning of the securities markets. Accordingly, the Commission preliminarily believes the proposed rule is appropriate to help ensure that a covered clearing agency can verify that its records are accurate and provide a complete accounting of its securities issues.

b. Periodic and At Least Daily Reconciliation of Securities Maintained

Proposed Rule 17Ad-22(e)(11)(ii) would require a covered CSD to establish, implement, maintain and enforce written policies and procedures reasonably designed to conduct periodic and at least daily reconciliation of securities issues it maintains.[265] The Commission preliminarily believes that the proposed requirement to reconcile on a daily basis securities maintained would (i) support the safeguarding of securities because, through such internal control procedures, accurate record-keeping is promoted and thereby safe, accurate, and effective clearing and settlement is also promoted, and (ii) further benefit issuers and holders, as discussed above, by potentially preventing unauthorized issuance of securities, dilution of a holder's positions, or the holder's claim on the security as beneficial owner where holding indirectly through a member of the CSD.

The Commission notes that CSDs in the United States currently do not provide registrar or transfer agent services to record name owners of securities. CSD services that facilitate book-entry transfer are limited to holding jumbo/global certificates in custody or, through sub-custodian relationships with the transfer agent for a particular issuer via the Fast Automated Securities Transfer ("FAST") system, which is used to maintain jumbo/global record ownership position balances of the CSD's holdings in a particular issue.[266] In both cases, custody or sub-custody facilitates book-entry transfer for ultimate beneficial owners as the CSD credits and debits the accounts of its members, which then maintain records of ownership and send account statements to their customers that are the ultimate beneficial owners. Since the registrar maintaining the security holder list for an issuer is not the CSD, the daily reconciliation

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265 See proposed Rule 17Ad-22(e)(11), infra Part VII. The Commission preliminary believes that daily reconciliation is appropriate for the reasons described in Part II.A.3.

266 For a description of DTC's rules relating to FAST, see Exchange Act Release Nos. 34-64191 (Apr. 5, 2011), 76 FR 20061 (Apr. 11, 2011); 34-61800 (Mar. 30, 2010), 75 FR 17196 (Apr. 5, 2010); 34-60196 (Jun. 30, 2009), 74 FR 33496 (Jul. 13, 2009); 34-46956 (Dec. 2, 2002), 67 FR 77115 (Dec. 16, 2002); 34-31941 (Mar. 3, 1993); 34-21401 (Oct. 16, 1984); 34-14997 (Jul. 26, 1978); and 34-13342 (Mar. 8, 1977).

requirement applicable to a covered CSD reconciling CSD ownership positions (that facilitate book-entry transfer for ultimate beneficial owners) against the record of such CSD ownership positions on the security holder list could not be done solely in-house but would require the CSD to coordinate with the registrar maintaining the security holder list for each issue that has been immobilized.[267]

c. Protect Assets against Custody Risk

Proposed Rule 17Ad-22(e)(11)(iii) would require a covered CSD to establish, implement, maintain and enforce written policies and procedures reasonably designed to protect assets against custody risk through appropriate rules and procedures consistent with relevant laws, rules, and regulations in jurisdictions where it operates.[268] The Commission preliminarily believes the proposed requirement to address custody risk is appropriate because a covered CSD faces risks of negligence, misuse of assets, fraud, record-keeping or administrative failures, loss, destruction, damage, natural disaster, and theft or other crime regarding assets held in custody. The Commission preliminarily believes that the proposed rule would further support Section 17A(b)(3)(F) of the Exchange Act, which requires the rules of a clearing agency to assure the safeguarding of securities and funds that are in the custody or control of the clearing agency or for which it is responsible.[269]

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267 Commonly, the entity performing the registrar and transfer services for an issue would be the same. Both functions are functions that place an entity within the definition of "transfer agent" pursuant to Section 3(a)(25) of the Exchange Act and the related regulatory regime for transfer agents. See 15 U.S.C. 78c(a)(25).

268 See proposed Rule 17Ad-22(e)(11), infra Part VII. For example, in the United States, additional safekeeping requirements may apply under state law. See, e.g., N.Y. UCC Law 8-504 (requires securities intermediaries, including clearing corporations, to exercise due care in accordance with reasonable commercial standards to obtain and maintain the financial asset).

269 See 15 U.S.C. 78q-1(b)(3)(F).

Such custody risk may be related to physical delivery risk, which proposed Rule 17Ad-22(e)(10) would require a covered clearing agency's policies and procedures to identify, monitor, and manage.[270] Operational risks may also be implicated, including those relating to personnel, which can be mitigated by having policies and procedures designed to review and assess the qualifications of potential employees, including reference and background checks and employee training, among other things. Additional operational risks include theft, loss, counterfeiting, and deterioration of or damage to assets.[271] Insurance coverage may be one way to mitigate such risk of theft, loss, counterfeiting, fraud, and damage to assets. Other appropriate methods to monitor and manage custody risks may include ensuring records of securities held in custody accurately reflect holdings and that employee duties for such recordkeeping for and holding of securities are separated.[272]

The Commission also preliminarily notes that increased dematerialization would not eliminate the applicability of the requirement to protect assets against custody risk. When held in electronic custody through accounting entries, such as through electronic sub-custody of the CSD global/jumbo record ownership position with a transfer agent via FAST, assets may nevertheless remain subject to operational risks and may be subject to variations of such risks, such as hacking or digital piracy, that are different from those risks faced with respect to paper certificates.

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270 See supra Part II.B.7 and infra Part VII (discussing the requirements under proposed Rule 17Ad-22(e)(10) and providing proposed rule text).

271 The Commission is also proposing Rule 17Ad-22(e)(17) to establish minimum standards for operational risk management. See infra Parts II.B.14 and VII.

272 The Commission is also proposing Rule 17Ad-22(e)(16) to establish minimum standards for custody and investment risk. See infra Parts II.B.13 and VII.

d. Request for Comments

The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(11). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered CSD's policies and procedures to maintain securities in an immobilized or dematerialized form for their transfer by book entry? Why or why not? Are there any circumstances under which this would be inappropriate? Please explain.
- Should the Commission require a covered CSD's policies and procedures to ensure the integrity of securities issues? Why or why not?
- Should the Commission require a covered CSD's policies and procedures to protect assets against custody risk through appropriate rules and procedures consistent with relevant laws, rules, and regulations in jurisdictions where it operates? Why or why not?
- Are there any other requirements that should be included in the proposed rule to promote sound practices at covered CSDs? For instance, should the Commission require a covered CSD's policies and procedures to include provisions to identify, measure, monitor, and manage its risks from other activities that it may perform? Should the Commission require a covered CSD's policies and procedures to employ a robust system that ensures segregation between the CSD's own assets and the securities of its participants and segregation among the securities of participants? Why or why not?

9. Proposed Rule 17Ad-22(e)(12): Exchange-of-Value Settlement Systems

Proposed Rule 17Ad-22(e)(12) would apply to transactions cleared by a covered clearing agency that involve the settlement of two linked obligations.[273] The proposed rule would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other, regardless of whether the covered clearing agency settles on a gross or net basis and when finality occurs.[274] The Commission preliminarily believes that the proposed rule is appropriate to help reduce the potential that delivery of a security is not appropriately matched with payment for the security, thereby impairing a covered clearing agency's ability to facilitate prompt and accurate clearance and settlement.

Rule 17Ad-22(d)(13) similarly requires that a registered clearing agency's policies and procedures be reasonably designed to eliminate principal risk by linking securities transfers to funds transfers in a way that achieves delivery versus payment ("DVP"),[275] though it does not specify that settlement should occur regardless of whether the clearing agency settles on a gross or net basis and when finality occurs. Because this is the only provision that differs between proposed Rule 17Ad-22(e)(12) and existing Rule 17Ad-22(d)(13), the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures.[276]

The Commission notes that ensuring settlement finality only when settlement of the corresponding obligation is final—regardless of whether a covered clearing agency settles on a

273 See proposed Rule 17Ad-22(e)(12), infra Part VII.

274 See id.

275 See 17 CFR 240.17Ad-22(d)(13); see also Clearing Agency Standards Release, supra note 5, at 66256.

276 See supra Part II.A.4.

gross or net basis—may require corresponding policies and procedures that address legal, contractual, operational, and other risks.[277] Given the risks that the size, operation, and importance of covered clearing agencies pose to the U.S. securities markets, the Commission preliminarily believes that this requirement is appropriate for covered clearing agencies.

Market confidence, in addition to public confidence more generally, hinges in large part on the dependability and promptness of the clearing and settlement systems underlying a given market. If CCPs are unable to promptly and fully give to clearing members access to funds due, they and other market participants may lose confidence in the settlement process.[278]

As under Rule 17Ad-22(d)(13), a covered clearing agency can link securities transfers to funds transfers and mitigate principal risk in connection with settlement through DVP settlement mechanisms. DVP is achieved in the settlement process when the mechanisms facilitating settlement ensure that delivery occurs only if payment occurs.[279] DVP eliminates the risk that a party would lose some or its entire principal because securities were delivered without payments being confirmed. The Commission notes that DVP settlement mechanisms are prevalent among registered clearing agencies because they eliminate principal risk and reduce the settlement risk

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277 See supra Parts II.B.1–3 and infra Parts II.B.14 and VII (discussing proposed rules establishing minimum standards for legal risk and governance arrangements, requiring a comprehensive risk management framework, requiring minimum standards for operational risk management, and providing proposed rule text in each case, respectively).

278 See Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Speeding Up Settlement: The Next Frontier, Remarks before the Symposium on Risk Reduction in Payments, Clearance and Settlement Systems (Jan. 26, 1996), available at http://www.sec.gov/news/speech/speecharchive/1996/spch071.txt.

279 See BIS, Delivery Versus Payment in Securities Settlement Systems (Sept. 1992), available at http://www.bis.org/publ/cpss06.pdf. Three different DVP models can be differentiated according to whether the securities and/or funds transfers are settled on a gross (trade-by-trade) basis or on a net basis. Proposed Rule 17Ad-22(e)(10), supra Part II.B.7 and infra Part VII, would establish minimum requirements for physical deliveries.

that arises in a securities transaction. A counterparty default absent a DVP settlement mechanism may cause substantial losses and liquidity pressures. Further, a settlement default could result in high replacement costs because the unrealized gain on an unsettled contract or the cost of replacing the original contract at market prices may change rapidly during periods of market stress.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(12). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to, if the covered clearing agency settles transactions that involve the settlement of two linked obligations, eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other? Should the Commission impose this policy and procedure requirement regardless of whether the covered clearing agency settles on a gross or net basis, as proposed? Should the Commission impose this policy and procedure requirement regardless of when finality occurs, as proposed? Why or why not?
- Does the proposed rule affect certain identifiable categories of covered clearing agencies differently than others, such as clearing agencies with more diversified post-trade services as compared to clearing agencies that specialize in fewer activities? If so, how? How should the proposed rule account for these differences?
- Are there operational or legal impediments to implementing the proposed rule? Would the proposed rule make it more difficult for covered clearing agencies to conduct certain types of business that may require a longer settlement cycle, for reasons outside of their

control? Are any additional rules or regulations needed to support achievement of the proposed rule?

- Are there circumstances when ensuring that the settlement of an obligation is final if and only if the settlement of the corresponding obligation is final is not feasible or practicable? If so, when?

10. Proposed Rule 17Ad-22(e)(13): Participant-Default Rules and Procedures

Proposed Rule 17Ad-22(e)(13) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations in the event of a participant default.[280] Because Rule 17Ad-22(d)(11) currently requires a registered clearing agency's policies and procedures to meet substantially the same requirements,[281] the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures to comply with the proposed rule.[282]

As with Rule 17Ad-22(d)(11), the Commission believes that proposed Rule 17Ad-22(e)(13) is appropriate given the importance of having established procedures in the event a

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280 See proposed Rule 17Ad-22(e)(13), infra Part VII. The Commission is proposing Rule 17Ad-22(e)(13) as part of a comprehensive set of rules for regulating covered clearing agencies that is consistent with and comparable to other domestic and international standards for FMIs.

281 Rule 17Ad-22(d)(11) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default. See 17 CFR 240.17Ad-22(d)(11); see also Clearing Agency Standards Release, supra note 5, at 66254–55.

282 See supra Part II.A.4.

covered clearing agency faces a member default. The proposed rule would continue to provide certainty and predictability to market participants about the measures a clearing agency will take in the event of a participant default as default procedures, among other things, are meant to reduce the likelihood that a default by one or more participants will disrupt the clearing agency's operations. By establishing, implementing, maintaining and enforcing such policies and procedures, a covered clearing agency should be in a better position to continue providing its services in a manner that promotes prompt and accurate clearance and settlement during times of market stress.[283] Accordingly, a covered clearing agency that has financial and operational triggers for default would need to ensure these are clearly defined.[284] In addition, where triggers are not automatic through the application of objective standards or thresholds, the discretion afforded a covered clearing agency to declare defaults would need to be clearly defined.[285] For example, a clear definition may include defining which person or group exercises discretionary authority in the event of default and providing specific examples of when the exercise of discretion is appropriate.

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283 The Commission is also proposing Rule 17Ad-22(e)(23) to require disclosure of rules, key procedures, and market data to members, market participants, and in certain circumstances the public. See infra Parts II.B.20 and VII (discussing the proposed rule and providing rule text, respectively).

284 An operational default may occur when a participant is not able to meet its obligations due to an operational problem, such as a failure in information technology systems. The Commission is proposing Rule 17Ad-22(e)(17) to establish minimum standards for operational risk management. See infra Parts II.B.14 and VII (discussing the proposed rule and providing rule text, respectively).

285 In this regard, the Commission notes that policies and procedures regarding participant default must satisfy the requirement for legal certainty in proposed Rule 17Ad-22(e)(1). See supra Part II.B.1.

The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it can take timely action to contain losses and liquidity pressures and to continue meeting its obligations when due in the event of a member default.[286] Default procedures are meant to reduce the likelihood that a default by a member, or multiple members, will disrupt the covered clearing agency's operations. Based on its supervisory experience, the Commission preliminarily believes such policies and procedures would address, among other things, the following: (i) accessing credit facilities, (ii) managing (which may include hedging open positions and funding collateral positions it is not prudent to close out immediately), transferring (such as through allocation or auction to other members) and/or closing out a defaulting member's positions; and (iii) transferring and/or liquidating applicable collateral. By employing policies and procedures that are designed to permit a covered clearing agency to take actions to contain losses and liquidity pressures it faces in the event of a participant default while continuing to meet its obligations, a covered clearing agency should be in a better position to continue providing its services in a manner that promotes accurate clearance and settlement during times of market stress.

A covered clearing agency should also have the operational capacity to comply with the proposed requirements to contain losses. The Commission preliminarily believes that the following measures would help promote such operational capacity: (i) establishing training programs for employees involved in default matters to ensure policies are well implemented; (ii) developing a communications strategy for communicating with stakeholders, including the

286 See proposed Rule 17Ad-22(e)(13), infra Part VII. A clearing agency may be able to contain liquidity pressures it faces by taking actions to secure additional sources of liquidity or limiting transactions that potentially serve to drain liquidity resources.

Commission, concerning defaults; and (iii) making sure the proper tools and resources (whether these are personnel or other) required are available to close out, transfer, or hedge open positions of a defaulting member promptly even in the face of rapid market movements.[287]

In addition, based on its supervisory experience, the Commission preliminarily believes that a covered clearing agency's default procedures would generally include the following: (i) the action that may be taken (e.g., exercising mutualization of losses); (ii) who may take those actions (e.g., the division of responsibilities when clearing agencies operate links to other clearing agencies); (iii) the scope of the actions that may be taken (e.g., any limits on the total losses that would be mutualized); (iv) potential changes to the normal settlement practices, should these changes be necessary in extreme circumstances, to ensure timely settlement; (v) the management of transactions at different stages of processing; (vi) the sequencing of actions; (vii) the roles, obligations, and responsibilities of the various parties, including non-defaulting members; (viii) the mechanisms to address a covered clearing agency's obligations to non-defaulting members (e.g., the process for clearing trades guaranteed by the covered clearing agency to which a defaulting member is a party); and (ix) the mechanisms to address the defaulting member's obligations to its customers (e.g., the process for dealing with a defaulting member's accounts).

In addition, proposed Rule 17Ad-22(e)(13) would include the requirements described below, for which no comparable requirements under Rule 17Ad-22(d) are applicable to registered clearing agencies. The Commission preliminarily believes the proposed requirements

[287] See supra note 284 and accompanying text. The Commission has also proposed Regulation Systems Compliance and Integrity ("Regulation SCI") to establish requirements for operational capacity. See infra note 326 and accompanying text.

are appropriate for covered clearing agencies given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets.

a. Address Allocation of Credit Losses

Proposed Rule 17Ad-22(e)(13)(i) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to address the allocation of credit losses it may face if its collateral and other resources are insufficient to fully cover its credit exposures, including the repayment of any funds the covered clearing agency may borrow from liquidity providers.[288]

The Commission preliminarily believes that this requirement is appropriate because requiring that policies and procedures address key aspects of the allocation of credit losses would provide certainty and predictability about the measures available to a covered clearing agency in the event of a default. Such certainty and predictability would facilitate the orderly handling of member defaults and would enable members to understand their obligations to the covered clearing agency in extreme circumstances. In some instances, managing a member default may involve hedging open positions, funding collateral so that the positions can be closed out over time, or both. A covered clearing agency may also decide to auction or allocate open positions to its participants. To the extent possible, the Commission believes a covered clearing agency would allow non-defaulting members to continue to manage their positions in the ordinary course. By addressing the allocation of credit losses, the covered clearing agency would have policies and procedures intended to address the resolution of a member default where its collateral and other financial resources are insufficient to cover credit losses.

288 See proposed Rule 17Ad-22(e)(13), infra Part VII.

b. Describe Replenishment of Financial Resources

Proposed Rule 17Ad-22(e)(13)(ii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to describe its process to replenish any financial resources it may use following a member default or other event in which use of such resources is contemplated.[289]

The Commission preliminarily believes this requirement is appropriate because the absence of procedures to replenish resources may undermine a covered clearing agency's ability to contain losses and liquidity pressures. The Commission also preliminarily believes that a covered clearing agency's rules and procedures to draw on financial resources will support the proposed rule's other requirements to contain losses and liquidity pressures. Such procedures commonly specify the order of use of different types of resources, including (i) assets provided by the defaulting member (such as margin or other collateral), (ii) the guaranty fund of the covered clearing agency, (iii) capital calls on members, and (iv) credit facilities. In addition, the Commission preliminarily believes a covered clearing agency could satisfy the proposed requirement by having policies and procedures that describe (i) how resources that have been depleted as a result of a member default would be replenished over time and (ii) what burdens a non-defaulting member may bear.

c. Test Default Procedures Annually and Following Material Changes

Proposed Rule 17Ad-22(e)(13)(iii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require its members and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close out procedures. The proposed rule would also require

289 See proposed Rule 17Ad-22(e)(13), infra Part VII.

policies and procedures providing for such testing and review to occur at least annually and following material changes thereto.[290] The Commission preliminarily expects that covered clearing agencies would make efforts to secure the participation of all stakeholders in such testing and review of default procedures but recognizes that covered clearing agencies may have limited ability to require said participation by all such stakeholders, and therefore the proposed rule requires such participation by other stakeholders only when practicable.

The Commission preliminarily believes that including members and other stakeholders in such testing will help to ensure that procedures will be practical and effective in the face of an actual default. In addition to the relevant employees, members, and other stakeholders that would be involved in testing default procedures, a covered clearing agency may determine, as appropriate, to include members of its board of directors or similar governing body, and to invite linked clearing agencies, significant indirect participants, providers of credit facilities, and other service providers to participate. The Commission preliminarily believes requiring member and, where practicable, stakeholder participation in periodic testing is appropriate because successful default management will require coordination among these parties, particularly during periods of market stress.

d. Request for Comments

The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(13). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to ensure the covered clearing agency has the authority and operational capacity to take

290 See proposed Rule 17Ad-22(e)(13), infra Part VII. The Commission preliminary believes that an annual testing cycle is appropriate for the reasons described in Part II.A.3.

timely action to contain losses and liquidity demands and continue to meet its obligations? Should the proposed rule include minimum requirements, as proposed? Why or why not?

- Should the Commission require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require its members and, when practicable, other stakeholders to participate in the testing and review of its default procedures? Why or why not? Is it appropriate for stakeholders other than a covered clearing agency's participants to participate in the testing and review of its default procedures? Why or why not? Should the Commission require policies and procedures that would require stakeholders to be included in testing unless a determination is made by the covered clearing agency that it would be impracticable to do so?

- Should the Commission require policies and procedures regarding specific default procedures for covered clearing agencies, or should they have discretion to create their own default procedures consistent with the proposed rule? If the latter, how much flexibility should a covered clearing agency have in its policies and procedures regarding the time it takes to manage a default and liquidate positions?

11. Proposed Rule 17Ad-22(e)(14): Segregation and Portability

Proposed Rule 17Ad-22(e)(14) would apply to a covered clearing agency that is either a security-based swap clearing agency or a complex risk profile clearing agency.[291] The proposed rule would require such a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to enable the segregation and portability of

291 See proposed Rule 17Ad-22(e)(14), infra Part VII.

positions of a member's customers and the collateral provided to the covered clearing agency with respect to those positions, and effectively protect such positions and related collateral from the default or insolvency of that member.[292] The Commission notes that security-based swap clearing agencies are currently not subject to rules regarding segregation and portability under existing Rule 17Ad-22.

The Commission preliminarily believes that proposed Rule 17Ad-22(e)(14) is appropriate because it facilitates the protection of customer collateral and positions by requiring a covered clearing agency's policies and procedures to prescribe means for holding or accounting for them separately from the assets of the clearing agency member providing services to the customer.

The Commission preliminarily believes that proposed Rule 17Ad-22(e)(14) should apply only to security-based swap clearing agencies and complex risk profile clearing agencies because existing rules applicable to broker-dealers address customer security positions and funds in cash securities and listed option markets, thereby promoting segregation and portability and protecting customer positions and funds.[293] The Commission considered certain international standards,

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292 See id.

293 Exchange Act Rule 15c3-3 requires broker-dealers that maintain custody of customer securities and cash (a "carrying broker-dealer") to take two primary steps to safeguard these assets. The steps are designed to protect customers by segregating their securities and cash from the broker-dealer's proprietary business activities. If the broker-dealer fails financially, the securities and cash should be readily available to be returned to customers. In addition, if the failed broker-dealer is liquidated in a formal proceeding under the Securities Investor Protection Act of 1970, the securities and cash would be isolated and readily identifiable as "customer property" and, consequently, available to be distributed to customers ahead of other creditors.

The first step required by Rule 15c3-3 is that a carrying broker must maintain physical possession or control of all fully paid and excess margin securities of their customers. See 17 CFR 240.15c3-3. Physical possession or control means the broker-dealer must hold these securities in one of several locations specified in Rule 15c3-3 and free of liens or any other interest that could be exercised by a third party to secure an obligation of the broker-dealer. Permissible locations include a bank, as defined in section 3(a)(6) of the Exchange Act, and a which recognize that cash market CCPs operate in legal regimes that achieve protection of customer assets by alternate means, in proposing Rule 17Ad-22(e)(14).[294] The Commission

clearing agency. As described herein, holding jumbo/global positions in the record name and custody of a clearing agency is a fundamental part of current U.S. market structure in which many holders hold indirectly through "street name."

The second step is that a carrying broker-dealer must maintain a reserve of cash or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers, including cash obtained from the use of customer securities. The account must be titled "Special Reserve Bank Account for the Exclusive Benefit of Customers." The amount of net cash owed to customers is computed pursuant to a formula set forth in Exhibit A to Rule 15c3-3. Under the customer reserve formula, the broker-dealer adds up customer credit items (e.g. cash in customer securities accounts and cash obtained through the use of customer margin securities) and then subtracts from that amount customer debit items (e.g. margin loans). If credit items exceed debit items, the net amount must be on deposit in the customer reserve account in the form of cash and/or qualified securities. A broker-dealer cannot make a withdrawal from the customer reserve account until the next computation and then even only if the computation shows that the reserve requirement has decreased. The broker-dealer must make a deposit into the customer reserve account if the computation shows an increase in the reserve requirement. See 17 CFR 240.15c3-3.

In addition, records of customer positions are subject to broker-dealer recordkeeping rules. Exchange Act Rules 17a-3 and 17a-4 require records be kept for certain periods of time, such as three or six year periods depending upon the type of record. See 17 CFR 240.17a-3, 17a-4.

See also 15 U.S.C. 78c-5 (providing for segregation with respect to security-based swaps pursuant to Section 3E of the Exchange Act); Exchange Act Release No. 34-68071 (Oct. 18, 2012), 77 FR 70213, (Nov. 23, 2012) (proposing Rule 18a-4 under the Exchange Act for segregation with respect to security-based swaps). The Commission has also granted conditional relief under Sections 3E(b), (d), and (e) of the Exchange Act to, among others, clearing entities dually registered with the Commission and the CFTC as registered clearing agencies and DCOs, respectively. See Exchange Act Release No. 34-68433 (Dec. 14, 2012), 77 FR 75211 (Dec. 19, 2012).

294 International standards recognize that regimes providing the same degree of protection as segregation and portability of customer positions at a CCP include the following features, in the event of a participant failure: (a) the customer positions can be identified timely, (b) customers will be protected by an investor protection scheme designed to move customer accounts from the failed participant to another participant in a timely manner, and (c) customer assets can be restored. See PFMI Report, supra note 1, at 83 (discussing Principle 14, Explanatory Note 3.14.6). The Commission preliminarily believes that the customer protections existing under the Commission's regulatory regime for broker-dealers include each of these three features and that

further notes that customer security positions and funds in cash securities and listed options markets are further protected under the Securities Investor Protection Act of 1970 ("SIPA").[295]

In addition, in so limiting the scope of proposed Rule 17Ad-22(e)(14), the Commission intends to avoid requiring changes to the existing structure of cash securities and listed options markets in the United States where registered clearing agencies that provide CSD or CCP services play a central role. Transactions in the U.S. cash security and listed options markets are characterized by the following features: (i) customers of members generally do not have an account at a clearing agency;[296] and (ii) the clearing agency is not able to identify which participants' customers beneficially own the street name positions registered in the record name of the clearing agency (or its nominee) and the clearing agency has no recourse to funds of customers of members. Therefore, in part because neither portability nor segregation could

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limiting the application of proposed Rule 17Ad-22(e)(14) in the manner described above is appropriate.

The Commission also notes that, separately, it has proposed Rule 18a-4 to apply customer protection rules to security-based swap dealers and major security-based swap participants. The approach in proposed Rule 18a-4 was modeled on the customer protection scheme under Rule 15c3-3 for broker-dealers. See Exchange Act Release No. 34-68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012).

295 See 15 U.S.C. 78eee et seq. Pursuant to SIPA, when a broker-dealer that is a member of the Securities Investor Protection Corporation ("SIPC") fails and customer assets are missing, SIPC seeks to return customer cash and securities, and supplements the distribution of the remaining customer assets at the broker-dealer with SIPC reserve funds of up to $500,000 per customer, including a maximum of $250,000 for cash claims.

296 A customer of a member also would not have an account at the clearing agency where holding in record name (rather than through street name ownership). This is the case even where such record name owner-customer does not receive a paper security certificate but holds in book-entry form through the direct registration system, as direct registration system accounts are maintained by a transfer agent and not by the clearing agency. See Exchange Act Release No. 34-63320 (Nov. 16, 2010), 75 FR 71473, 71474 (Nov. 23, 2010) (discussing the ability of registered owners to hold their assets on the records of transfer agents in book-entry form through the direct registration system).

occur as a practical matter under the current cash securities and listed options markets structure, the Commission preliminarily believes that Proposed Rule 17Ad-22(e)(14) should apply only to a covered clearing agency that is either a security-based swap clearing agency or a complex risk profile clearing agency.

The Commission notes that segregation can be achieved either through an omnibus account structure, as is common in the U.S. securities markets today, or an individual account structure. An omnibus account structure, where all collateral belonging to all customers of a particular member is commingled and held in a single account segregated from that of the member, might not be as operationally intensive as an individual account structure. Omnibus accounts may expose a customer to "fellow-customer risk" (i.e. the risk that another customer of the same member will default) in the event of a loss that exceeds the amount of available collateral posted by the fellow customer who has defaulted and the available resources of the member, in which case the remaining commingled collateral of the member's non-defaulting customers may be exposed to the loss. Fellow-customer risk is of particular concern because customers may have limited ability to monitor or to manage the risk of their fellow customers. To mitigate this risk, omnibus account structures can be designed in a manner that operationally commingles collateral related to customer positions while protecting customers legally on an individual basis.[297] This may require a covered clearing agency to rely on the records of its members or maintain its own books reflecting customer-level interest in the customer's portion of collateral.

297 See, e.g., Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336 (Feb. 7, 2012) (CFTC adopting rules imposing on DCOs legal segregation with operational commingling ("LSOC") for cleared swaps).

An omnibus account structure may be more efficient when porting positions and collateral for a group of customers subject to a defaulting member (where there has been no customer default or where customer collateral is legally protected on an individual basis). Omnibus accounts may also foster portability depending on whether the covered clearing agency collects margin on a gross or net basis. Margin calculated on a gross basis to support individual customer portfolios may result in less efficient netting with respect to members; however, it may eliminate the possibility of under-margined customer positions when ported. As a result, a clearing agency may be able to port in bulk or piecemeal the positions of a customer of a member that has defaulted. When margin is collected on a net basis, there may be a risk that full portability cannot be achieved if under-margining means that porting will depend on the ability and willingness of customers to provide additional collateral where transferee members are unwilling to accept the porting to them of under-margined positions.

Alternatively, an individual account structure may also provide a high degree of protection from the default of another customer of a member, as a customer's collateral is intended to be used to cover losses associated solely with the default of that customer. In the event of a member failure (whether or not due to a customer default), clear and reliable identification of a customer's collateral may promote portability of an individual customer's positions and collateral or, alternatively, expedite their return to the customer. Maintaining individual accounts, however, can be operationally and resource intensive for a covered clearing agency and could impact the overall efficiency of its clearing operations. An individual account structure may also impact margin collection practices at a covered clearing agency, as the individual account structure may be inconsistent with net collection of margin because it may be impractical for the covered clearing agency to allocate the net margin to individual customers rather than among omnibus accounts.

The Commission preliminarily notes that a covered clearing agency subject to the proposed rule would be required to structure its portability arrangements in a way that makes it highly likely that the positions and collateral of a defaulting member's customers will be effectively transferred to one or more other members. The Commission also preliminarily notes that the following methods may assist a covered clearing agency in achieving portability: (i) identifying positions that belong to customers; (ii) identifying and asserting rights to related collateral held by or through the covered clearing agency; (iii) identifying potential members to accept the positions and collateral; (iv) disclosing relevant information to such members so that they can evaluate the counterparty credit and market risk associated with the customers and positions, respectively; (v) transferring positions and related collateral to one or more members; and (vi) carrying out default management procedures in an orderly manner.

Finally, where a covered clearing agency's policies and procedures facilitating portability permit a transfer of specific positions and collateral that is not performed with the consent of the member to whom they are transferred, the Commission preliminarily believes that a covered clearing agency could satisfy this requirement by having policies and procedures that set out the circumstances where this may occur. In addition, the Commission preliminarily notes that the portability requirement does not apply only upon default of a member; a covered clearing agency should have policies and procedures that facilitate porting in the normal course of business, such as when a customer ends its relationship with a member to start a new relationship with a different member, or as a result of other events, such as a merger involving the member.[298]

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(14). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to enable the segregation and portability of positions of a participant's customers and the collateral provided to the covered clearing agency with respect to those positions? Why or why not?
- Should the Commission require a covered clearing agency's policies and procedures to effectively protect the positions of a participant's customers and related collateral from the default or insolvency of that participant? Why or why not?
- Does the proposed rule affect certain identifiable categories of covered clearing agencies differently than others in ways not discussed in this proposing release? If so, how? Should the requirements under the proposed rule apply to certain identifiable categories of covered clearing agencies in addition to security-based swap and complex risk profile clearing agencies, as proposed? Please explain.

12. Proposed Rule 17Ad-22(e)(15): General Business Risk

Proposed Rule 17Ad-22(e)(15) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage its general business risk and hold sufficient liquid net assets

298 In this regard, the Commission notes that policies and procedures regarding segregation and portability must satisfy the requirement for legal certainty in proposed Rule 17Ad-22(e)(1). See supra Part II.B.1.

funded by equity to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize.[299] Registered clearing agencies are not subject to rules regarding general business risk under existing Rule 17Ad-22, but the Commission preliminarily believes the proposed rule is appropriate for covered clearing agencies given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets.

Proposed Rule 17Ad-22(e)(15) is designed to help mitigate the potential impairment of a covered clearing agency's status as a going concern resulting from general business losses, such as a decline in revenues or an increase in expenses resulting in expenses that exceed revenues and a loss that must be charged against the covered clearing agency's capital.[300] The Commission preliminarily believes that proposed Rule 17Ad-22(e)(15) is appropriate because it would help to mitigate the risk of a disruption in clearance and settlement services that might result from general business losses. The Commission preliminarily believes that such impairment could be caused by a variety of business factors, including poor execution of business strategy, negative cash flows, or unexpected and/or excessively large operating expenses. The Commission preliminarily believes that general business losses should be considered separately in the covered clearing agency's risk management policies and procedures to promote effective and efficient measuring, monitoring, and management of general business

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299 See proposed Rule 17Ad-22(e)(15), infra Part VII.

300 General business risk is the risk of potential losses arising from the covered clearing agency's administration and operation as a business enterprise. Such losses are not related to member default under proposed Rule 17Ad-22(e)(13) nor covered by the financial resources required for credit and liquidity risk management under proposed Rules 17Ad-22(e)(4) and (7). See supra Parts II.B.4.c, II.B.4.f, and II.B.10 and infra Part VII (proposing rules for managing credit risk, liquidity risk, and participant default, and providing proposed rule text, respectively).

risk. The risk of general business losses may require a firm to take into account past loss events and financial projections, events distinct from the risks that arise from member default, credit losses, or liquidity shortfalls.[301] Proposed Rule 17Ad-22(e)(15) would require a covered clearing agency to establish implement, maintain and enforce written policies and procedures reasonably designed to address the management of general business risk and the development of a business risk profile to address these concerns.[302]

In addition, the Commission is proposing the requirements described below. Registered clearing agencies are not subject to similar rules under Rule 17Ad-22, but the Commission preliminarily believes the proposed requirements are appropriate for covered clearing agencies given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets and are consistent with the Exchange Act requirements discussed above.[303]

a. Determining Liquid Net Assets for Recovery and an Orderly Wind-Down

Proposed Rule 17Ad-22(e)(15)(i) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to determine the amount of liquid net assets funded by equity based upon its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken.[304] The Commission

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301 See id.

302 See proposed Rule 17Ad-22(e)(15), infra Part VII.

303 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

304 See proposed Rule 17Ad-22(e)(15)(i), infra Part VII.

preliminarily believes that plans for orderly recovery and wind-down are critical to maintain functioning U.S. securities markets, particularly in times of market stress. Because of the reliance of securities markets, market participants, and investors on the safe, sound, and efficient operations of covered clearing agencies, the Commission believes that a disorderly failure of a covered clearing agency would have systemic consequences. Accordingly, the Commission is proposing to require liquid net assets funded by equity to ensure that the covered clearing agency can continue operations and services as a going concern in the event of general business losses. Equity allows a covered clearing agency to absorb losses on an ongoing basis and should therefore be permanently available for this purpose. The specific amount of liquid net assets funded by equity that a covered clearing agency should hold is discussed in more detail below.

b. Requirements for Liquid Net Assets

Proposed Rule 17Ad-22(e)(15)(ii) would require a clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for holding liquid net assets funded by equity equal to the greater of either six months of its current operating expenses or the amount determined by the board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing agency, as contemplated by the plans established under proposed Rule 17Ad-22(e)(3)(ii).[305] A clearing agency's policies and procedures would require these liquid net assets to be held in addition to resources held to cover participant defaults or other risks covered under

[305] See proposed Rule 17Ad-22(e)(15)(ii), infra Part VII; see also supra Part II.B.3.b (discussing recovery and wind-down plans under proposed Rule 17Ad-22(e)(3)(ii)).

the credit risk standard in proposed Rules 17Ad-22(e)(4)(i) through (iii) and the liquidity risk standard in proposed Rules 17Ad-22(e)(7)(i) and (ii).[306]

The Commission preliminarily believes that the requirements for a covered clearing agency's policies and procedures regarding liquid net assets are necessary to ensure that a covered clearing agency's general business risk management is sufficiently robust to facilitate either its orderly recovery or wind-down. The Commission is proposing these requirements to ensure that a covered clearing agency's policies and procedures clearly define what liquid net assets are sufficient under Rule 17Ad-22(e)(15) and to require a covered clearing agency to maintain, pursuant to its policies and procedures, liquid net assets appropriate to cover general business risk in addition to those resources appropriate for managing participant default, credit losses, or liquidity shortfalls. Based on its supervisory experience, the Commission preliminarily believes that a covered clearing agency could satisfy this requirement by having policies and procedures that limit appropriate liquid net assets to cash or cash equivalents because these types of assets would best facilitate continued operations if a clearing agency experienced general business losses.[307] Further, the Commission preliminarily believes that a covered clearing agency could satisfy this requirement by having policies and procedures that fund liquid net

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306 See supra Parts II.B.4.c and f and infra Part VII (discussing requirements under proposed Rules 17Ad-22(e)(4) and (e)(7), respectively, and providing proposed rule text).

307 Regarding marketable securities that may be included as cash equivalents within liquid net assets, the Commission has not proposed to require such assets to be readily available and convertible into cash through certain funding arrangements as it has proposed under Rule 17Ad-22(e)(7)(ii) (which incorporates proposed Rule 17Ad-22(a)(15) defining "qualifying liquid resources"). The Commission preliminarily believes the amount of liquidity needed to cover participant defaults in the context of proposed Rule 17Ad-22(e)(7) may be significantly greater than the amount of liquidity needed to cover general business losses, and it is therefore appropriate to permit the use of such assets in the context of proposed Rule 17Ad-22(e)(7)(ii), in order to provide greater flexibility to covered clearing agencies regarding liquidity risk management.

assets by common stock, disclosed reserves, or other retained earnings in order to ensure that a covered clearing agency has a permanent source of capital from which to draw in order to continue as a going concern in the case of general business losses for at least a six month period or in accord with a determination of the board of directors of the covered clearing agency.[308] Assets funded by debt or other less permanent sources of capital would not achieve this result and in some circumstances could further complicate the resolution process of a covered clearing agency.

The Commission also preliminarily believes that a backward-looking calculation of operating expenses based on the income statement for the most recently ended fiscal year would not be the type of policy and procedure sufficient to comply with the proposed requirements regarding current operating expense.[309] While reviewing past losses and past levels of operating expense may be a useful reference point, the Commission envisions that one possible approach a covered clearing agency could take in fulfillment of the proposed requirement would be to consider projected operating expense expected over some time period, as well as potential changes to the business environment of the covered clearing agency over that time period. Based

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308 The Commission preliminarily believes it is appropriate to apply the limitation that liquid net assets be funded by equity in proposed Rule 17Ad-22(e)(15) but has not proposed such limitation in Rule 17Ad-22(e)(4) (regarding financial resources required to manage credit risk) or Rule 17Ad-22(e)(7)(ii) (regarding qualifying liquid resources in relevant currencies required to manage liquidity risk) because equity allows a covered clearing agency to absorb losses on an ongoing basis so that it can continue operations as a going concern. Cf. PFMI Report, supra note 1, at 90 & n.137.

In addition, the Commission preliminarily believes a covered clearing agency may exclude depreciation and amortization expenses from its calculation of current operating expenses because depreciation and amortization expenses are non-cash expenses and accordingly would not have an effect on a covered clearing agency's cash flow, which might affect its ability to continue operations as a going concern.

309 See id. at 90.

on its supervisory experience, the Commission also believes that the following factors may materially affect current operating expenses, as compared to operating expense experienced in the past, that a covered clearing agency may need to take into account and therefore are likely to be important to the covered clearing agency's forward-looking projections: (i) expectations regarding expansion of its business including as a result of offering new services or clearing and settling new types of securities, (ii) expectations regarding contraction of its business including due to reduction in or loss of certain types of clearing and settlement activity or clearing members, (iii) potential risk of any large one-time or non-recurring types of losses, and (iv) the degree to which expected future losses may be covered by insurance or an indemnity provided by a third-party unaffiliated with the covered clearing agency.

The proposed rule also requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for monitoring its business operations and reducing the likelihood of losses, which the Commission believes furthers the requirements of the Exchange Act discussed above.[310]

Because of the integral role that liquid net assets play in supporting the recovery or orderly wind-down of a covered clearing agency in the event of a business loss, the Commission is proposing requirements for a clearing agency's policies and procedures to require liquid net assets, funded by equity, equal to the greater of six months of operating expenses or an amount determined by the board of directors to be sufficient to facilitate an orderly recovery or wind-down of critical operations and services. The Commission preliminarily believes this is appropriate because liquid net assets allow the covered clearing agency to continue operations as

[310] See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

a going concern by acting as a cushion while the covered clearing agency is in recovery or wind-down.

c. Plan for Raising Additional Equity

Proposed Rule 17Ad-22(e)(15)(iii) would further require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for maintaining a viable plan, approved by the board of directors and updated at least annually, for raising additional equity should its equity fall close to or below the amount required by the proposed rule as discussed above.[311]

As noted above, because of the reliance of securities markets, market participants, and investors on the safe, sound, and efficient operations of covered clearing agencies, a disorderly failure of a covered clearing agency would have systemic consequences. The proposed rule requires a covered clearing agency to maintain a viable plan to raise additional equity in the event that its liquid net assets funded by equity fall close to or below the amount required by the proposed rule.[312] The Commission preliminarily believes that the proposed rule is necessary to facilitate ongoing management of a covered clearing agency's general business risk and to provide a covered clearing agency with a mechanism for maintaining or replenishing appropriate levels of equity following business losses.

d. Request for Comments

The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(15). In addition, the Commission requests comments on the following specific issues:

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[311] See proposed Rule 17Ad-22(e)(15)(ii), infra Part VII.

[312] See proposed Rule 17Ad-22(e)(15)(iii), infra Part VII.

- Should the Commission require a covered clearing agency's policies and procedures to identify, monitor, and manage the covered clearing agency's general business risk? Why or why not? Are there other requirements that the Commission should include in proposed Rule 17Ad-22(e)(15) to address the general business risk management at covered clearing agencies?

- Is the proposed requirement for a covered clearing agency's policies and procedures to hold liquid net assets funded by equity equal to the greater of either (x) six months of the covered clearing agency's current operating expenses or (y) the amount determined by the board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing agency appropriate? Why or why not? Under the proposed requirement for policies and procedures, is six months of operating expenses appropriate? Should the Commission adopt a different standard, such as three, nine, or twelve months? Please explain in detail why using an alternative standard would be appropriate.

- Should the Commission require a covered clearing agency's policies and procedures to hold liquid net assets in addition to resources held to cover participant defaults or other risks covered under the credit risk standard in Rule 17Ad-22(b)(3)? Under the credit risk standard in proposed Rules 17Ad-22 (e)(4)(i) through (iii), as applicable? Under the liquidity risk standard in proposed Rules 17Ad-22(e)(7)(i) and (ii), as applicable? Why or why not? Has the Commission provided sufficient guidance regarding what constitutes "liquid net assets"? Why or why not?

- Should a covered clearing agency be required to provide notice to the Commission at any time before its liquid net assets reach the minimum required amount? If so, at what amount should the requirement apply, e.g. at 110% of the minimum, 120% of the minimum, or some other amount?[313]

- Regarding securities that are cash equivalents and therefore liquid net assets, should the Commission establish requirements for policies and procedures that discount the value of these securities compared to their fair value?

13. Proposed Rule 17Ad-22(e)(16): Custody and Investment Risks

Proposed Rule 17Ad-22(e)(16) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to safeguard its own and its participants' assets and minimize the risk of loss and delay in access to these assets.[314] It also requires a clearing agency to invest its own and its participants' assets in instruments with minimal credit, market, and liquidity risks.[315] Rule 17Ad-22(d)(3) currently requires similar policies and procedures of registered clearing agencies, but the proposed rule would further require a covered clearing agency to have policies and procedures designed to safeguard its own and its participants' assets.[316] The Commission preliminarily believes this

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313 See, e.g., Commission Delegated Regulation No. 152/2013 of 19 December 2012, 2013 O.J. (L 52), at art. 1(3) (European Union requiring that, if the required amount of capital held by a CCP is lower than 110% of the capital requirements or lower than 110% of £7.5 million (the "notification threshold"), the CCP shall immediately notify the competent authority and keep it updated at least weekly, until the amount of capital held by the CCP returns above the notification threshold).

314 See proposed Rule 17Ad-22(e)(16), infra Part VII.

315 See id.

316 Registered clearing agencies are currently subject to existing Rule 17Ad-22(d)(3), which requires them to establish, implement, maintain and enforce written policies and procedures reasonably designed to hold assets in a manner that minimizes risk of loss or of delay in its access to them, and invest assets in instruments with minimal credit, market, and liquidity risks. See 17 CFR 240.17Ad-22(d)(3); see also Clearing Agency Standards Release, supra note 5, at 66247–48.

additional specificity is appropriate for covered clearing agencies given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets. Because this is the only element of Rule 17Ad-22(e)(16) that differs from Rule 17Ad-22(d)(3), the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures to comply with the proposed rule.[317]

Custody risk is the risk of loss on assets held in custody in the event of a custodian's (or subcustodian's) insolvency, negligence, fraud, or poor administration. Investment risk is the risk of loss faced by a clearing agency when it invests its own or its participants' assets. In each case, the risk is the likelihood that assets securing participant obligations to the covered clearing agency or otherwise needed for the clearing agency to meet its own obligations would be unavailable or insufficient when the covered clearing agency needs to draw on them. Failure by a clearing agency to hold assets in instruments with minimal credit, market, and liquidity risk may limit the clearing agency's ability to retrieve these assets promptly. That, in turn, can cause the clearing agency to fail to meet its settlement obligations to its participants or cause the clearing agency's participants to fail to meet their obligations. Accordingly, as under Rule 17Ad-22(d)(3), the Commission believes it is appropriate to continue to limit such risks to ensure the proper functioning of a covered clearing agency pursuant to Section 17A of the Exchange Act.[318] The Commission also preliminarily believes that requiring a covered clearing agency to

317 See supra Part II.A.4.

318 The Commission preliminarily believes, however, that it should not indirectly prohibit the use of commercial banks by covered clearing agencies holding cash as collateral or for other services related to clearance and settlement activity when comparable services are available from a central bank.

have policies and procedures that safeguard its own and its participants' assets further supports this objective.

Under existing Rule 17Ad-22(d)(3), the members of a registered clearing agency typically deposit securities with the clearing agency, or the clearing agency holds assets that secure the participants' obligations to it and may invest these assets. In such circumstances, the clearing agency is exposed to custody and investment risk. The Commission is aware that, currently, clearing agencies ordinarily seek to minimize the risk of loss or delay in access by holding assets that are highly liquid (e.g., cash, U.S. Treasury securities, or securities issued by a U.S. government agency) and by using only supervised and regulated entities such as banks to act as custodians for the assets and to facilitate settlement. Steps are also ordinarily taken to ensure assets held in custody are protected against claims of a custodian's creditors through trust accounts or other equivalent arrangements. In addition, the use of individual custodians is subject to periodic assessment across several risk criteria and should remain within acceptable concentration limits.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(16). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to invest its own and its participants' assets in instruments with minimal credit, market, and liquidity risks? Why or why not?
- Should the Commission require a covered clearing agency's policies and procedures to minimize the risk of loss and delay in access to its own and its participants' assets? Why or why not?

- Has the Commission provided sufficient guidance regarding what instruments have "minimal credit, market, and liquidity risks"? Should the Commission further specify what kinds of assets would be appropriate under the proposed requirement, such as investments that are secured by, or are claims on, high-quality obligors and investments that allow for timely liquidation with little, if any, adverse price effect? Why or why not?
- Should covered clearing agencies ever be permitted to hold assets in instruments that do not have minimal credit, market, and liquidity risk? If so, why and under what circumstances? What type of measures should covered clearing agencies have in place to minimize the risk of loss from delays in accessing these assets? Should the proposed rule specify any such requirements? Should the Commission develop more specific criteria regarding how covered clearing agencies may hold or invest assets?

14. Proposed Rule 17Ad-22(e)(17): Operational Risk Management

Proposed Rule 17Ad-22(e)(17) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to manage the covered clearing agency's operational risk.[319] Operational risk involves, among other things, the likelihood that deficiencies in information systems or internal controls, human errors or misconduct, management failures, unauthorized intrusions into corporate or production systems, or disruptions from external events such as natural disasters, would adversely affect the functioning of a clearing agency. Proposed Rule 17Ad-22(e)(17)(i) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures,

[319] See proposed Rule 17Ad-22(e)(17), infra Part VII.

and controls.[320] Proposed Rule 17Ad-22(e)(17)(ii) would require the covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to ensure that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity.[321] Proposed Rule 17Ad-22(e)(17)(iii) further requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a business continuity plan that addresses events posing a significant risk of disrupting operations.[322] Rule 17Ad-22(d)(4) currently requires a registered clearing agency to have policies and procedures that are substantially similar to those in proposed Rules 17Ad-22(e)(17)(i) through (iii).[323] Although proposed Rules 17Ad-22(e)(17)(i) through (iii) differ from Rule 17Ad-22(d)(4) in contemplating both internal and external operational risks, a high degree of security and operational reliability for systems, and, in the context of business continuity plans, events posing a significant risk of disrupting operations, the Commission preliminarily believes that a covered clearing agency may need to make only limited changes to update its policies and procedures. The Commission preliminarily believes

320 See proposed Rule 17Ad-22(e)(17)(i), infra Part VII.

321 See proposed Rule 17Ad-22(e)(17)(ii), infra Part VII. By requiring "adequate, scalable capacity," the Commission preliminarily believes that a covered clearing agency should have operational systems that can be extended or expanded based on its anticipated business needs.

322 See proposed Rule 17Ad-22(e)(17)(iii), infra Part VII.

323 Rule 17Ad-22(d)(4) requires a registered clearing agency to establish policies and procedures reasonably designed to identify sources of operational risk and minimize them through the development of appropriate systems, controls, and procedures. It also requires registered clearing agencies to establish policies and procedures reasonably designed to implement systems that are reliable and secure, and have adequate, scalable capacity; and have business continuity plans that allow for timely recovery of operations and fulfillment of a clearing agency's obligations. See 17 CFR 240.17Ad-22(d)(4); see also Clearing Agency Standards Release, supra note 5, at 66248–49.

these requirements are appropriate for covered clearing agencies given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets.

As with Rule 17Ad-22(d)(4), the Commission preliminarily believes that the requirements in proposed Rule 17Ad-22(e)(17)(i) through (iii) should help covered clearing agencies and its participants continue to address and manage risks posed by potential operational deficiencies. Specifically, to help limit disruptions that may impede the proper functioning of a covered clearing agency, the Commission preliminarily believes it is imperative that covered clearing agencies review their operations for potential weaknesses and develop appropriate systems, controls, and procedures to address weaknesses the proposed rule seeks to mitigate.

The Commission intends for proposed Rule 17Ad-22(e)(17) to supplement the existing guidance provided by the Commission in its Automation Review Policy ("ARP") statements[324] and the Interagency White Paper on Sound Practices to Strengthen the Resilience of the U.S.

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324 See Automated Systems of Self-Regulatory Organizations, Exchange Act Release No. 34-27445 (Nov. 16, 1989), 54 FR 48703 (Nov. 24, 1989) ("ARP I"); Automated Systems of Self-Regulatory Organizations (II), Exchange Act Release No. 34-29815 (May 9, 1991), 56 FR 22489 (May 15, 1991) ("ARP II").

Generally, the guidance in ARP I and ARP II provides for the following activities by clearing agencies: (1) performing periodic risk assessments of its automated data processing ("ADP") systems and facilities; (2) providing for the selection of the clearing agency's independent auditors by non-management directors and authorizing such non-management directors to review the nature, scope, and results of all audit work performed; (3) having an adequately staffed and competent internal audit department; (4) furnishing annually to participants audited financial statements and an opinion from an independent public accountant as to the clearing agency's system of internal control –including unaudited quarterly financial statements also should be provided to participants upon request; and (5) developing and maintaining plans to assure the safeguarding of securities and funds, the integrity of the ADP system, and recovery of securities, funds, or data under a variety of loss or destruction scenarios.

Financial System.[325] The Commission also preliminarily believes that the proposed rules are consistent with the Commission's objectives in proposed Regulation SCI.[326]

Request for Comments. The Commission generally requests comments on all aspects of proposed Rules 17Ad-22(e)(17). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to manage its operational risks by establishing and maintaining a business continuity plan that addresses events posing a significant risk of disrupting operations? Why or why not? Has the Commission provided sufficient guidance on what an event "posing a significant risk of disrupting operations" would be?
- Should the Commission's proposal require a specific methodology to identify and mitigate operational risk? If so, what is the methodology and why should this methodology be imposed?
- Is the Commission's proposed approach with respect to ensuring that systems have a high degree of security, resiliency, and operational reliability appropriate and sufficiently clear? Why or why not?

325 See Exchange Act Release No. 34-47638 (Apr. 7, 2003), 68 FR 17809 (Apr. 11, 2003), available at http://www.sec.gov/news/studies/34-47638.htm.

326 Proposed Rule 17Ad-22(e)(17) would not conflict with the Commission's proposed Regulation SCI, should the Commission determine at a later date to adopt those rules as proposed. Proposed Regulation SCI would, however, subject all covered clearing agencies to certain requirements, including requirements for operational risk management and business continuity planning, in addition to those that appear in this proposal. See Exchange Act Release No. 34-69077 (Mar. 8, 2013), 78 FR 18083, 18091–141 (Mar. 25, 2013).

- Are there any other requirements that should be included in the rule to facilitate policies and procedures for operational risk management? Why or why not?
- Should the Commission adopt additional policies and procedures requirements for business continuity planning? If so, please explain in detail.

15. Proposed Rule 17Ad-22(e)(18): Access and Participation Requirements

Proposed Rule 17Ad-22(e)(18) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation,[327] which permit fair and open access by direct and, where relevant, indirect participants and other FMUs.[328]

In addition to the requirements described above,[329] Section 17A of the Exchange Act requires registered clearing agencies to have rules not designed to permit unfair discrimination in the admission of participants.[330] The Commission has historically used its authority to help ensure fair access and participation requirements.[331] In this regard, the Commission notes that

327 The Commission notes that, in contrast to other requirements in Rule 17Ad-22(e) where "transparent" is used and permits disclosure "where appropriate" pursuant to Rule 17Ad-22(a)(20), the requirement here for policies and procedures designed to ensure "publicly disclosed" criteria for participation would require policies and procedures requiring such disclosure.

328 See proposed Rule 17Ad-22(e)(18), infra Part VII.

329 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

330 See 15 U.S.C. 78q-1(b)(3)(F).

331 See, e.g., 17 CFR 240.17Ad-22(b)(5) through (7), (d)(2); Clearing Agency Standards Release, supra note 5, at 66238–43, 66246–47 (adopting minimum access and participation requirements for registered clearing agencies); Exchange Act Release No. 34-16900 (June 17, 1980), 45 FR 41920 (June 23, 1980) (outlining staff guidance establishing minimum standards for participation and fair access necessary for registration as a clearing agency).

Rules 17Ad-22(b)(5) through (7) impose requirements regarding access and participation for the policies and procedures of registered clearing agencies that provide CCP services.[332] Similarly, Rule 17Ad-22(d)(2) requires a registered clearing agency to establish policies and procedures for access and participation that require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the CCP and have procedures in place to monitor that participation requirements are met on an ongoing basis.[333]

Appropriate minimum operational, legal, and capital requirements for membership that are maintained and enforced through the supervisory practices of a clearing agency help to ensure all members will be reasonably capable of meeting their various obligations to the clearing agency in stressed market conditions and upon member default. Member defaults challenge the safe functioning of a clearing agency by creating credit and liquidity risks, which impede a clearing agency's ability to settle securities transactions in a timely manner. Ensuring

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[332] See 17 CFR 240.17Ad-22(b)(5) through (7); Clearing Agency Standards Release, supra note 5, at 66238–43. The Commission notes that covered clearing agencies providing CCP services would remain subject to the requirements under Rule 17Ad-22(b), in addition to the requirements under proposed Rule 17Ad-22(e)(18).

[333] Rule 17Ad-22(d)(2) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to (i) require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency; (ii) have procedures in place to monitor that participation requirements are met on an ongoing basis; (iii) have participation requirements that are objective and publicly disclosed, and permit fair and open access. See 17 CFR 240.17Ad-22(d)(2); see also Clearing Agency Standards Release, supra note 5, at 66246–47.

The Commission notes that the elements of Rule 17Ad-22(d)(2)(i), regarding policies and procedures requiring participants to have financial resources and robust operational capacity to meet obligations arising from participation are also reflected in other proposed rules, including Rules 17Ad-22(e)(4) and (17). See supra Parts II.B.4.c (requiring under proposed Rule 17Ad-22(e)(4) policies and procedures for testing the sufficiency of financial resources) and II.B.14 (requiring under proposed Rule 17Ad-22(e)(17) policies and procedures for operational risk management).

that clearing members meet objective levels of operational and financial soundness helps to counterbalance the potential for cascading effects on other participants and limit the potential of a systemic disruption in the U.S. securities markets. Fair and open access to all parties meeting the objective criteria for participation similarly helps to ensure wide participation and thereby increase beneficial risk mitigating effects.

Accordingly, the Commission preliminarily believes Rule 17Ad-22(e)(18) is appropriate because it would promote membership standards at covered clearing agencies that are likely to limit the potential for member defaults and, as a result, losses to non-defaulting members in the event of a member default. The proposed rule has similar requirements to those applied to registered clearing agencies under Rule 17Ad-22(d)(2) but would also explicitly require a covered clearing agency's policies and procedures to establish publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other FMUs, and also require that the criteria be risk-based, in addition to objective.[334] The Commission preliminarily believes the requirement that policies and procedures for publicly disclosed criteria for participation that specify fair and open access by both direct and indirect participants and other FMUs is appropriate because of the size and reach of covered clearing agencies, which are likely to transact or link with many participants, both direct and indirect, as well as other FMUs. The Commission also preliminarily believes that the requirement for risk-based criteria helps protect investors and facilitates prompt and accurate

[334] The Commission is proposing Rule 17Ad-22(e)(18) as part of a comprehensive set of rules for regulating covered clearing agencies that is consistent with and comparable to other domestic and international standards for FMIs. Because of the similarity between the existing requirement in Rule 17Ad-22(d)(2)(iii) and these requirements under proposed Rule 17Ad-22(e)(18), the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures to comply with these requirements under the proposed rule. See supra Part II.A.4.

clearance and settlement by helping to ensure that covered clearing agencies accept participants that are less prone to default.

In addition, the Commission is proposing a requirement that covered clearing agencies establish, implement, maintain and enforce written policies and procedures reasonably designed to require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency and to monitor compliance with participation requirements on an ongoing basis. Rule 17Ad-22(d)(2)(i) and (ii) also require a registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to have procedures in place to require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency and to monitor that participation requirements are met on an ongoing basis.[335] Because these other requirements in proposed Rule 17Ad-22(e)(18) are the same as those for registered clearing agencies more generally under existing Rule 17Ad-22(d)(2), the Commission anticipates that covered clearing agencies may need to make only limited changes to update their policies and procedures.[336] As with Rule 17Ad-22(d)(2), the Commission believes these requirements are appropriate because they would further support membership standards at covered clearing agencies that are likely to limit the potential for member defaults and, as a result, losses to non-defaulting members in the event of a member default.

335 See supra note 333 and accompanying text.

336 See supra Part II.A.4 (noting the anticipated effect of the proposed rule) and infra Part IV.B.3.c (describing the current practices at registered clearing agencies regarding settlement).

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(18). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to monitor compliance with its participation requirements on an ongoing basis? Why or why not? Would a more specific monitoring requirement be appropriate? For example, should this requirement specify a frequency of review? Why or why not?. If so, what would be the appropriate frequency of review? Please explain.
- Would it be appropriate for the Commission to require a covered clearing agency's policies and procedures to provide for different categories of participation? If so, please explain in detail what these different categories would be and why they would be appropriate.

16. Proposed Rule 17Ad-22(e)(19): Tiered Participation Agreements

Proposed Rule 17Ad-22(e)(19) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage the material risks to the covered clearing agency arising from arrangements in which firms that are indirect participants in the covered clearing agency rely on the services provided by direct participants in the covered clearing agency to access the covered clearing agency's payment, clearing, or settlement facilities (hereinafter "tiered participation arrangements").[337] The Commission preliminarily believes the proposed rule is appropriate due

[337] See proposed Rule 17Ad-22(e)(19), infra Part VII. Because proposed Rule 17Ad-22(e)(19) only addresses the situation where a covered clearing agency relies on direct participants, the proposed rule does not apply to a broker-dealer that is a member of a CSD and maintains accounts for retail customers.

to the associated dependencies and risk exposures that tiered participation arrangements create, as discussed above. Such risks, including credit, liquidity, and operational risks, can undermine the operations of a covered clearing agency and pose risks to the operations of a clearing agency's participants, both direct and indirect, and to the broader securities markets as well.

Registered clearing agencies are currently not subject to rules regarding tiered participation arrangements under existing Rule 17Ad-22. The Commission preliminarily believes the proposed rule is appropriate for covered clearing agencies, given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets, and is consistent with the requirements of the Exchange Act discussed above.[338]

The Commission has previously noted that, in situations where direct access to clearing agencies is limited by reasonable participation standards, firms that do not meet these standards may still be able to access clearing agencies through correspondent clearing arrangements with direct participants.[339] Such a process would involve the non-participant entering into a correspondent clearing arrangement with a participant so that the transaction may be submitted by the participant to the clearing agency. The dependencies and risk exposures, including credit, liquidity, and operational risks, inherent in tiered participation arrangements present risks to a clearing agency and its functioning, in addition to the direct participant. A covered clearing agency with direct participants that clear transactions on behalf of indirect participants with large

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338 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

339 See Exchange Act Release No. 34-63107 (Oct. 14, 2010), 75 FR 65882 (Oct. 26, 2010) (proposing ownership limitations and governance requirements for security-based swap clearing agencies, security-based swap execution facilities, and national securities exchanges with respect to security-based swaps under Regulation MC).

values or volumes faces the risk of default by both the indirect participant itself and the direct participant through which those transactions are routed. Accordingly the Commission is proposing Rule 17Ad-22(e)(19) to promote the ongoing management of risks associated with such tiered participation arrangements.

In addition, the Commission is proposing to require that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to regularly review the material risks to the covered clearing agency arising from such tiered participation arrangements.[340] The Commission preliminarily believes the proposed requirement is appropriate due to the ongoing dependencies and risk exposures that tiered arrangements present to the operation of a covered clearing agency and to the operation of a covered clearing agency's participants. Registered clearing agencies are currently not subject to a similar requirement under existing Rule 17Ad-22, and that the proposed rule is appropriate for covered clearing agencies, given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets, and is consistent with the requirements of the Exchange Act discussed above.[341]

The operational, financial, and other interconnections between direct and indirect participants to tiered participation arrangements are subject to market forces and can therefore change over time. Because direct and indirect participants collectively contribute to the operational and financial stability of a covered clearing agency, the Commission preliminarily believes that the requirement to regularly review a covered clearing agency's tiered participation

340 See proposed Rule 17Ad-22(e)(19), infra Part VII.

341 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

arrangements supports the Exchange Act requirements that clearing agencies be able to facilitate prompt and accurate clearance and settlement, protect investors and the public interest, and ensure the safeguarding of securities and funds in the custody or control of the clearing agency or for which the clearing agency is responsible.[342]

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(19). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to identify, monitor and manage the material risks to the covered clearing agency arising from arrangements in which firms that are indirect participants in the covered clearing agency rely on the services provided by direct participants to access the covered clearing agency's payment, clearing, or settlement facilities? Why or why not?
- Has the Commission provided sufficient guidance regarding who would be "indirect participants" and "direct participants"? Why or why not?

17. Proposed Rule 17Ad-22(e)(20): Links

Proposed Rule 17Ad-22(e)(20) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link with one or more other clearing agencies, FMUs, or trading markets.[343] Rule 17Ad-22(d)(7) requires registered clearing agencies to have

342 See 15 U.S.C 78q-1(b)(3)(A).

343 See proposed Rule 17Ad-22(e)(20), infra Part VII.

policies and procedures for evaluating the potential sources of risks that can arise from links.[344] For the purposes of Rule 17Ad-22(e)(20), however, the Commission would further define "link" in proposed Rule 17Ad-22(a)(10) to mean any set of contractual and operational arrangements between a covered clearing agency and one or more other clearing agencies, FMUs, or trading venues that connect them directly or indirectly for the purposes of participating in settlement, cross margining, expanding its services to additional instruments and participants, or for any other purposes material to their business.[345] The Commission preliminarily believes this expanded and more prescriptive approach to defining a link is appropriate for covered clearing agencies given their size, global operation, and importance to the U.S. securities markets.

In addition to the requirements discussed above,[346] Section 17A of the Exchange Act directs the Commission to facilitate the establishment of linked or coordinated facilities for clearance and settlement.[347] Links between clearing agencies, FMUs, and trading markets develop in several circumstances for different reasons. A CCP may establish a link with another

344 Rule 17Ad-22(d)(7) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to evaluate the potential sources of risks that can arise when the clearing agency establishes links either cross-border or domestically to clear or settle trades, and ensure that the risks are managed prudently on an ongoing basis. See 17 CFR 240.17Ad-22(d)(7); see also Clearing Agency Standards Release, supra note 5, at 66250–51.

345 See proposed Rule 17Ad-22(a)(10), infra Part VII.

346 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

347 See 15 U.S.C. 78q-1(a)(2)(A)(ii); see also 15 U.S.C. 78q-1(a)(1)(D) (Congress finding that the linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors).

CCP to enable a participant in the first CCP to clear trades with a participant in the second CCP. Similarly, a CSD may establish a link with another CSD to enable its participants to access services provided by the other CSD. Clearing agencies may also generally establish links with trade repositories and trading markets to fulfill regulatory obligations.

Accordingly, the Commission is proposing Rule 17Ad-22(e)(20) to ensure that covered clearing agencies identify and assess the potential sources of risk arising from a link arrangement and incorporate that analysis into its risk management policies and procedures. In certain cases, the creation of a link may raise risks similar to those raised by tiered participation arrangements and participant requirements, discussed above: namely, the interconnections between the clearing agency and the other entity may increase the risks to the clearing agency stemming from, among other things, the risks of participant default, credit losses, or liquidity shortfalls arising through the linked entity rather than the clearing agency's own operations.[348] The range of implicated risks is broad; a clearing agency that operates links may increase its exposure to legal, operational, custody, settlement, credit, and liquidity risk depending on the nature and extent of the link involved.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(20) and 17Ad-22(a)(10). In addition, the Commission requests comments on the following specific issue:

- Should the Commission require a covered clearing agency's policies and procedures to identify, monitor, and manage risks related to any link the covered clearing agency

[348] See supra Parts II.B.15 and 16 (discussing the access and participation requirements in proposed Rule 17Ad-22(e)(18) and requirements for tiered participation arrangements in proposed Rule 17Ad-22(e)(19)).

establishes with one or more other clearing agencies, FMUs, or trading markets? Why or why not?

- Is the definition of "link" in proposed Rule 17Ad-22(a)(10) appropriate and sufficiently clear in light of the proposed requirements? Why or why not? Is there an alternative definition that the Commission should consider?

18. Proposed Rule 17Ad-22(e)(21): Efficiency and Effectiveness

Proposed Rule 17Ad-22(e)(21) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it is efficient and effective in meeting the requirements of its participants and the markets it serves.[349] Rule 17Ad-22(d)(6) similarly requires registered clearing agencies to have policies and procedures designed to be cost-effective in meeting the requirements of participants while maintaining safe and secure operations.[350]

Proposed Rule 17Ad-22(e)(21) would further require a covered clearing agency's management to regularly review the efficiency and effectiveness of its (i) clearing and settlement arrangements; (ii) operating structure, including risk management policies, procedures, and systems; (iii) scope of products cleared, settled, or recorded; and (iv) use of technology and communication procedures.[351] The Commission preliminarily believes this requirement for

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349 See proposed Rule 17Ad-22(e)(21), infra Part VII.

350 Rule 17Ad-22(d)(6) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to be cost-effective in meeting the requirements of participants while maintaining safe and secure operations. See 17 CFR 240.17Ad-22(d)(6); see also Clearing Agency Standards Release, supra note 5, at 66250.

351 See proposed Rule 17Ad-22(e)(21), infra Part VII.

regular review is appropriate for covered clearing agencies given the risks that a covered clearing agency's size, global operation, and importance pose to the U.S. securities markets.[352]

For purposes of the proposed rule, efficiency refers generally to the efficient use of resources by a clearing agency to perform its functions, and effectiveness refers to its ability to meet its intended goals and objectives. A covered clearing agency that operates inefficiently or functions ineffectively may distort financial activity and market structure, increasing not only the risks borne by its members, but also the risks of indirect participants, such as the customers of participants or other buyers and sellers of securities. If a covered clearing agency is inefficient, a participant may choose not to trade or may choose to settle bilaterally, which could potentially result in greater risks to the U.S. financial system than would otherwise occur in the presence of a more efficiently functioning covered clearing agency.

In addition to the requirements discussed above,[353] Section 17A of the Exchange Act requires that registered clearing agencies have rules designed to promote the prompt and accurate clearance and settlement of securities transactions,[354] following a finding by Congress that inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors.[355] The Commission

352 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

353 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

354 See 15 U.S.C. 78q-1(b)(3)(F).

355 See 15 U.S.C. 78q-1(a)(1)(B); see also 15 U.S.C. 78q-1(a)(1)(C) (Congress finding that new data processing and communications techniques create the opportunity for more efficient, effective, and safe procedures for clearance and settlement).

preliminarily believes that proposed Rule 17Ad-22(e)(21) is appropriate because a covered clearing agency must be designed and operated to meet the needs of its participants and the markets it serves, while remaining sufficiently flexible to respond to changing demand and new technologies.

The Commission is also proposing to require that a covered clearing agency regularly review the items identified in Rule 17Ad-22(e)(21)(i) through (iv) because the Commission preliminarily believes that they are reflective of key aspects of a clearing agency's business necessary for efficient and effective operation. Moreover, because technology, sound practices, market forces, and the number and characteristics of participants may change over time, the Commission preliminarily believes that measures of efficiency and effectiveness must be subject to policies and procedures for regular review.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(21). In addition, the Commission requests comments on the following specific issues:

- Has the Commission provided sufficient guidance on what policies and procedures would be necessary to ensure that a covered clearing agency is "efficient and effective" in meeting the requirements of the proposed rule? Why or why not?
- Is the proposed requirement for a covered clearing agency's policies and procedures to regularly review the following aspects of its business and operations appropriate: clearing and settlement arrangements; operating structure, including risk management policies, procedures, and systems; the scope of products cleared, settled, or recorded; and the use of technology and communication procedures? Why or why not? Should the

Commission require that other aspects of a covered clearing agency's business and operations be subject to regular review?

19. Proposed Rule 17Ad-22(e)(22): Communication Procedures and Standards

Proposed Rule 17Ad-22(e)(22) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it uses, or at a minimum accommodates, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, and settlement.[356] No comparable requirement exists for registered clearing agencies under Rule 17Ad-22(d). The Commission preliminarily believes this proposed requirement is appropriate for covered clearing agencies given a covered clearing agency's size and global operation. The Commission understands that covered clearing agencies currently use the relevant internationally accepted communication procedures and standards,[357] so the Commission expects only limited changes may be necessary to satisfy the requirements of the proposed rule.

The ability of participants to communicate with a covered clearing agency in a timely, reliable, and accurate manner is important to achieving prompt and accurate clearance and settlement. The Commission preliminarily believes that requiring policies and procedures in line with internationally accepted communication procedures and standards is appropriate for a covered clearing agency for two reasons. First, internationally accepted communication procedures and standards, because they are widely accepted and adopted standards, reduce the

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356 See proposed Rule 17Ad-22(e)(22), infra Part VII.

357 See generally Finacle, Messaging Standards in Financial Industry, (Infosys Thought Paper, 2012), available at http://www.infosys.com/finacle/solutions/thought-papers/Documents/messaging-standards-financial-industry.pdf (describing messaging standards such as SWIFT, FIX, and Fpml).

likelihood of errors and technical complexity in the clearance and settlement process, thereby reducing risks and costs, improving efficiency, and reducing barriers to entry. Such procedures and standards would include standardized protocols for exchanging messages and reference data for identifying financial instruments and counterparties.

Second, internationally accepted communication procedures and standards ensure effective communication with direct and indirect participants, which the Commission preliminarily believes is important for covered clearing agencies, given the global nature of their businesses. Securities markets in the United States are among the largest and most actively traded in the world, with direct and indirect participants from numerous other countries that necessitate the development and use of internationally accepted communication procedures and standards. Accordingly, the Commission preliminarily believes that covered clearing agencies are likely to be engaged in transactions across borders, where standardized communications protocols and mechanisms are essential to ensure prompt and accurate clearance and settlement.

Request for Comments. The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(22). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, and settlement? Why or why not?
- Is the Commission's assumption that covered clearing agencies are already using internationally accepted communication procedures correct? Why or why not?

- Has the Commission provided sufficient guidance on what "relevant internationally accepted communication procedures and standards" would be appropriate under the proposed policies and procedures requirement? Why or why not?

20. Proposed Rule 17Ad-22(e)(23): Disclosure of Rules, Key Procedures, and Market Data

Proposed Rule 17Ad-22(e)(23) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain clear and comprehensive rules and procedures that provide for the specific disclosures enumerated in the rule, as discussed below.[358] The proposed rule would require such policies and procedures to specifically require a covered clearing agency to (i) publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures; (ii) provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency; and (iii) publicly disclose relevant basic data on transaction volume and values.[359] As with public

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358 See proposed Rule 17Ad-22(e)(23), infra Part VII; see also Parts II.B.20.a and b (discussing the specific disclosures enumerated in the proposed rule).

The Commission is proposing Rule 17Ad-22(e)(23) as part of a comprehensive set of rules for regulating covered clearing agencies that is consistent with and comparable to other domestic and international standards for FMIs.

The Commission notes that Rule 17Ad-22(c)(2) currently requires a registered clearing agency, within 60 days after the end of its fiscal year, to post on its website its annual audited financial statements. See 17 CFR 240.17Ad-22(c)(2); see also Clearing Agency Standards Release, supra note 5, at 66244.

359 In full, Rule 17Ad-22(d)(9) requires registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide market participants with sufficient information for them to identify and evaluate the risks and costs associated with using its services. See 17 CFR 240.17Ad-22(d)(9); see also Clearing Agency Standards Release, supra note 5, at 66252–53.

disclosures contemplated under proposed Rule 17Ad-22(a)(20), a covered clearing agency could comply with the proposed requirement by posting the relevant documentation to its website. The Commission preliminarily believes the proposed rule is appropriate to promote continued transparency at covered clearing agencies and thereby continue to facilitate prompt and accurate clearance and settlement.

Rule 17Ad-22(d)(9) currently requires registered clearing agencies to have policies and procedures to facilitate disclosures similar to proposed Rule 17Ad-22(e)(23)(ii), but does not require policies and procedures similar to proposed Rules 17Ad-22(e)(23)(i) and (iii). The Commission preliminarily believes these additional requirements are appropriate for a covered clearing agency given the risks that a covered clearing agency's size, operation, and importance pose to the U.S. securities markets because these disclosures provide the relevant authorities with information that further facilitates supervision of the covered clearing agency, including information that may allow the relevant authorities to better assess the covered clearing agency's observance of risk management requirements and better identify possible risks posed by the covered clearing agency, and provide relevant stakeholders with information regarding risks associated with participation in a covered clearing agency.

In addition to the Exchange Act requirements described above,[360] Section 17A of the Exchange Act requires registered clearing agencies to have rules designed to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.[361] The Commission preliminarily believes that requiring a covered clearing agency

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360 See notes 54–56 and accompanying text; see also Parts I.A and B (generally discussing the regulatory framework under Section 17A of the Exchange Act, as amended by the Dodd-Frank Act).

361 See 15 U.S.C. 78q-1(b)(3)(F).

to have policies and procedures reasonably designed to disclose sufficient information so that participants can identify risks and costs associated with using the covered clearing agency would allow participants to make informed decisions about the use of the covered clearing agency and to take appropriate actions to mitigate their risks and to better understand the costs associated with their use of the covered clearing agency. Similarly, the Commission preliminarily believes that requiring a covered clearing agency to publicly disclose relevant basic data on transaction volume and values would allow regulators, market participants, and market observers to make informed decisions about the activities of the covered clearing agency and to take appropriate action, if necessary, in response.

Pursuant to existing Commission regulations, changes to the rules of an SRO, including clearing agencies, are required to be available on the SRO's website and are published by the Commission.[362] The Commission's proposed rule is designed to promote understanding among market participants of the policies and procedures of covered clearing agencies, and the Commission believes the proposed rule is consistent with existing requirements for SROs. Continued and improved understanding of the risks and costs associated with using a covered clearing agency's services should promote confidence generally in the covered clearing agency's ability to set and manage appropriately risks and costs, such as margin requirements, restrictions on or limitations of the covered clearing agency's obligations, and conditions used by the covered clearing agency to test the adequacy of its financial resources. The Commission

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[362] See 17 CFR 240.19b-4(l) (requiring an SRO to post each proposed rule change, and any amendments thereto, on its website within two business days of filing with the Commission); 17 CFR 240.19b-4(i) (requiring SROs to retain for public inspection and copying all filings made pursuant to this section and all correspondence and other communications reduced to writing, including comment letters, to and from such SRO concerning any such filing).

preliminarily believes these requirements are especially important for covered clearing agencies given their size and importance.

The Commission notes that these policies and procedures requirements are intended in part to codify disclosure practices currently undertaken by some registered clearing agencies on an elective basis.[363]

Below is a discussion of the specific disclosures required under the proposed rule, which are not similarly required of registered clearing agencies under Rule 17Ad-22(d)(9). The Commission preliminarily believes that these additions to a covered clearing agency's disclosure practices are important to ensure clearing members and the public have access to up-to-date information about the covered clearing agency's activities, policies, and procedures, which would promote confidence in its operations and thereby contribute to the prompt and accurate clearance and settlement of securities transactions.[364]

a. Comprehensive Public Disclosure

Proposed Rule 17Ad-22(e)(23)(iv) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain clear and comprehensive rules and procedures that provide for a comprehensive public disclosure of its material rules, policies, and procedures regarding governance arrangements and legal, financial, and operational risk management, accurate in all material respects at the time of

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363 See, e.g., DTC, Assessment of Compliance with Recommendations for Securities Settlement Systems (Dec. 2011), available at http://dtcc.com/legal/policy-and-compliance.aspx.

364 As noted above, the Commission preliminarily believes that the proposed requirement for a comprehensive public disclosure is consistent with the requirements of the Exchange Act, Rule 19b-4, and the current practices of some clearing agencies that would be covered clearing agencies. See supra notes 362–363 and accompanying text; see also Part IV.B.3.i (discussing the current practices of registered clearing agencies with respect to transparency and disclosure).

publication, including (i) a general background of the covered clearing agency, including its function and the market it serves, basic data and performance statistics on its services and operations, such as basic volume and value statistics by product type, average aggregate intraday exposures to its participants, and statistics on the covered clearing agency's operational reliability, and a description of its general organization, legal and regulatory framework, and system design and operations; (ii) a standard-by-standard summary narrative for each applicable standard set forth in proposed Rules 17Ad-22(e)(1) through (22) with sufficient detail and context to enable the reader to understand its approach to controlling the risks and addressing the requirements in each standard; (iii) a summary of material changes since the last update of the disclosure; and (iv) an executive summary of the key points regarding each.[365] The Commission is proposing to require that the comprehensive public disclosure provide basic data and performance statistics, such as statistics on the covered clearing agency's operational reliability so that the relevant stakeholders and the general public have data regarding, for example, performance targets for systems and the actual performance of systems over specified periods and targets for recovery. The Commission is also proposing to require that the comprehensive public disclosure include a standard-by-standard summary narrative to elicit a summary discussion of a covered clearing agency's implementation of policies and procedures requirements that would need to be established, implemented, maintained and enforced by a covered clearing agency in response to proposed Rules 17Ad-22(e)(1) through (23). In addition, the Commission is proposing to require a summary of material changes and would expect that a covered clearing agency should consider its particular circumstances, such as, for example,

[365] See proposed Rule 17Ad-22(e)(23)(iv), infra Part VI.

changes in the scope of services provided by the covered clearing agency, in satisfying this requirement.

The Commission preliminarily believes that disclosure of the above required information will provide participants with the information necessary to, at a minimum, identify and evaluate the risks and costs associated with use of the covered clearing agency, thereby promoting transparency and enhancing competition and market discipline. The Commission preliminarily believes it would also provide other stakeholders, including regulators and the public, with information that facilitates informed oversight and decision-making regarding covered clearing agencies.

b. Updates to the Comprehensive Public Disclosure

Proposed Rule 17Ad-22(e)(23)(v) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the comprehensive public disclosure required under proposed Rule 17Ad-22(e)(23)(iv) is updated not less than every two years, or more frequently following changes to its system or the environment in which it operates to the extent necessary, to ensure statements previously provided remain accurate in all material respects.[366] The Commission preliminarily believes that ensuring statements previously provided remain accurate would require a covered clearing agency's comprehensive public disclosure to provide statements that would provide a market participant with an accurate representation of the risks and costs of participating in the covered clearing agency.

The Commission preliminarily believes that this requirement would help provide participants, regulators, other stakeholders, and the public with disclosures that are current,

366 See proposed Rule 17Ad-22(e)(23)(v), infra Part VI.

accurate, and comprehensive, thereby promoting transparency and enhancing competition and market discipline. The Commission preliminarily believes it would also provide other stakeholders, including regulators and the public, with timely information that facilitates informed oversight and decision-making regarding covered clearing agencies, thereby promoting the clearing agency obligations required under Section 17A of the Exchange Act.[367]

c. Request for Comments

The Commission generally requests comments on all aspects of proposed Rule 17Ad-22(e)(23). In addition, the Commission requests comments on the following specific issues:

- Should the Commission require a covered clearing agency's policies and procedures to maintain clear and comprehensive rules and procedures that provide for the specific disclosures proposed under Rule 17Ad-22(e)(23)? Why or why not? Are there rules and procedures that should not be fully disclosed to participants? Please explain in detail what such rules and procedures would be and why they should not be disclosed to participants.
- In imposing certain minimum requirements for policies and procedures regarding the comprehensive public disclosure, has the Commission provided sufficient guidance regarding what elements must appear in the disclosure? Should different elements appear? Should the Commission require policies and procedures to update the comprehensive public disclosure every two years, as proposed? Should the Commission require policies and procedures to update the comprehensive public disclosure more frequently following changes to its system or the environment in which it operates to the

[367] See 15 U.S.C. 78q-1(b)(3)(F).

extent necessary to ensure the statements provided remain accurate in all material respects? Why or why not?

- Are certain ways that covered clearing agencies communicate information to market participants more effective than others? For example, does including information in a covered clearing agency's rulebook or published interpretive materials provide adequate notice of the risks and costs of being a participant to persons that are not currently participants in the covered clearing agency? Why or why not?
- Should the types of information that a covered clearing agency discloses under the proposed rule be generally available to the public? Should any categories of the information required to be disclosed under the proposed rule be restricted to certain parties only, such as clearing members or the Commission itself? Why or why not?
- Should the Commission require covered clearing agencies to make public disclosures of information contained in their audited financial statements that would provide a discussion and analysis of the covered clearing agency's financial condition, in particular with respect to liquidity, capital resources, and results of operations, similar to the Management's Discussion and Analysis of Financial Condition and Results of Operations disclosure required under Items 303(a)(1) through (3) of Regulation S-K?
- Should the Commission require that policies and procedures pursuant to proposed Rule 17Ad-22(e)(23) specify a certain form for the disclosures (e.g., using tagged or structured data)? Why or why not? What form should the proposed disclosures take? Please explain.

C. Proposed Rule 17Ab2-2

The Commission is proposing Rule 17Ab2-2 to establish procedures for the Commission to make determinations affecting covered clearing agencies.[368] Under the proposed rule, the Commission would make determinations in three cases, as discussed below. In each case, under proposed Rule 17Ab2-2(d), the Commission would publish notice of its intention to consider such determinations, together with a brief statement of the grounds under consideration, and provide at least a 30-day public comment period prior to any determination.[369] The Commission may provide the clearing agency subject to the proposed determination opportunity for hearing regarding the proposed determination. Under proposed Rule 17Ab2-2(e), notice of determinations in each case would be given by prompt publication thereof, together with a statement of written reasons supporting the determination.[370]

The Commission notes that under proposed Rule 17Ad-22(e), five active registered clearing agencies would meet the definition of a covered clearing agency without action under proposed Rule 17Ab2-2 by the Commission.[371] Because the two dormant registered clearing agencies would not meet the definition of a covered clearing agency, if they elected to begin providing clearance and settlement services, they could potentially be subject to a determination

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368 See proposed Rule 17Ab2-2, infra Part VII.

369 See proposed Rule 17Ab2-2(d), infra Part VII.

370 See proposed Rule 17Ab2-2(e), infra Part VII.

371 See supra notes 82–87 and accompanying text. As noted, the CFTC has been designated the supervisory agency for two registered clearing agencies, CME and ICE, which have been designated as systemically important by the FSOC pursuant to the Clearing Supervision Act, and accordingly they would not be covered clearing agencies under proposed Rules 17Ad-22(e) and 17Ab2-2.

under Rule 17Ab2-2.[372] In addition, the Commission notes that it would consider, upon receiving an application for registration as a clearing agency, either making a determination regarding a registrant's status as a covered clearing agency as part of the registration process, if the Commission believes the clearing agency already meets the definition of a covered clearing agency, or after registration, if the Commission determines that the clearing agency does not meet the definition of a covered clearing agency upon registration but does so at a later date, as either market conditions or the characteristics of the clearing agency itself change, pursuant to proposed Rule 17Ab2-2.[373]

1. Determination that a Registered Clearing Agency is a Covered Clearing Agency

Under proposed Rule 17Ab2-2(a), the Commission may, if it deems appropriate, upon application by any registered clearing agency or member thereof, or on its own initiative, determine whether a registered clearing agency should be considered a covered clearing agency.[374] In determining whether a registered clearing agency should be considered a covered clearing agency, the Commission may consider characteristics such as the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults or other such factors as it deems appropriate in the circumstances. The Commission preliminarily believes it should reserve the right to make a determination on its own initiative in the event that it independently determines that a registered clearing agency meets the definition of a covered clearing agency, as either market conditions or

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372 See supra note 88 and accompanying text.

373 See supra note 9 and accompanying text (discussing the requirements for registration as a clearing agency pursuant to Section 17A of the Exchange Act).

374 See proposed Rule 17Ab2-2(a), infra Part VII.

the characteristics of the clearing agency itself change. The Commission preliminarily believes that the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults are two factors that indicate a registered clearing agency may raise systemic risk concerns supporting application of the requirements under proposed Rule 17Ad-22(e).[375]

The Commission preliminarily believes that proposed Rule 17Ab2-2(a) would provide the Commission with the flexibility necessary to achieve the goals of Section 17A of the Exchange Act,[376] Title VII of the Dodd-Frank Act,[377] and the Clearing Supervision Act,[378] given the ever-changing nature of the U.S. securities markets, including the nature and character of participants in the market and the products required to be cleared and settled in practice. The Commission preliminarily believes that Rule 17Ab2-2(a) is necessary to ensure that a registered clearing agency not otherwise meeting the definition of either a designated clearing agency or a complex risk profile clearing agency can nonetheless be subject to the requirements for covered clearing agencies in proposed Rule 17Ad-22(e) upon a determination made by the Commission. The Commission preliminarily believes this is necessary to ensure that the Commission is appropriately able to respond to registered clearing agencies that raise systemic risk concerns supporting application of the requirements under proposed Rule 17Ad-22(e).

375 See Clearing Agency Standards Release, supra note 5, at 66234 n.162 (describing the risks that arise from financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults).

376 See supra Part I.A.

377 See supra Part I.B.1.

378 See supra Part I.B.2.

2. Determination that a Covered Clearing Agency Is Systemically Important in Multiple Jurisdictions

Under proposed Rule 17Ab2-2(b), the Commission may, if it deems appropriate, upon application by any clearing agency or member thereof, or on its own initiative, determine whether a covered clearing agency meets the definition of "systemically important in multiple jurisdictions."[379] In determining whether a covered clearing agency is systemically important in multiple jurisdictions, the Commission may consider (i) whether the covered clearing agency is a designated clearing agency; (ii) whether the clearing agency has been determined to be systemically important by one or more jurisdictions other than the United States through a process that includes consideration of whether the foreseeable effects of a failure or disruption of the designated clearing agency could threaten the stability of each relevant jurisdiction's financial system;[380] or (iii) such other factors as the Commission may deem appropriate in the circumstances.

The Commission preliminarily believes that it should propose the procedures set forth in Rule 17Ab2-2(b) for designating a covered clearing agency as systemically important in multiple jurisdictions. Accordingly, the Commission is proposing Rule 17Ab2-2(b) to provide procedures for determining when a clearing agency has become systemically important in multiple jurisdictions. In this regard, the Commission preliminarily believes that proposed Rule 17Ab2-

379 See proposed Rule 17Ab2-2(b), infra Part VII.

380 The Commission notes that this provision of proposed Rule 17Ab2-2(b) parallels the definition of systemic importance in Section 803(9) of the Clearing Supervision Act, which states that systemic importance means a situation where the failure of or a disruption to the functioning of an FMU could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States. See 12 U.S.C. 5462(9).

2(b)(ii) is consistent with Section 804(a)(2)(D) of the Clearing Supervision Act.[381] The Commission is also proposing that it may consider additional factors in determining whether a covered clearing agency is systemically important in multiple jurisdictions, in addition to whether the foreseeable effects of a failure or disruption of the designated clearing agency could threaten the stability of multiple jurisdictions' financial systems. Such analysis could include whether foreign regulatory authorities have designated the covered clearing agency as systemically important and whether any findings were made in anticipation of that designation.

3. Determination that a Clearing Agency Has a More Complex Risk Profile

Under proposed Rule 17Ab2-2(c), the Commission may, if it deems appropriate, determine whether any of the activities of a clearing agency providing central counterparty services, in addition to clearing agencies registered with the Commission for the purpose of clearing security-based swaps, have a more complex risk profile.[382] In determining whether a clearing agency's activity has a more complex risk profile, the Commission may consider (i) characteristics such as the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults; and (ii) such other characteristics as it deems appropriate in the circumstances. The Commission preliminarily believes that the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults are

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381 See 12 U.S.C. 5463(a)(2)(D) (listing, as one of the systemic importance criteria for the FSOC to consider, the effect that the failure of or a disruption to the FMU or PCS activity would have on critical markets, financial institutions, or the broader financial system).

382 See proposed Rule 17Ab2-2(c), infra Part VII.

two factors that indicate a registered clearing agency raises systemic risk concerns supporting application of the requirements under proposed Rule 17Ad-22(e).[383]

The Commission preliminarily believes that proposed Rule 17Ab2-2(c) would provide the Commission with the flexibility necessary to achieve the goals of Section 17A of the Exchange Act,[384] Title VII of the Dodd-Frank Act,[385] and the Clearing Supervision Act,[386] given the dynamic nature of the U.S. securities markets, including the nature and character of participants in the market and the products required to be cleared and settled in practice, by permitting the Commission to determine that certain registered clearing agencies are complex risk profile clearing agencies. The Commission also preliminarily believes that activities involving a more complex risk profile, because they may involve the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults, implicate systemic risk concerns supporting application of the requirements under proposed Rule 17Ad-22(e).[387]

4. Request for Comments

The Commission generally requests comments on all aspects of proposed Rule 17Ab2-2. In addition, the Commission requests comments on the following specific issues:

- Should the Commission establish procedures for making determinations affecting covered clearing agencies? Why or why not?

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383 See supra note 375 and accompanying text.

384 See supra Part I.A.

385 See supra Part I.B.1.

386 See supra Part I.B.2.

387 See supra note 375 and accompanying text.

- In determining whether a clearing agency should be considered a covered clearing agency, should the Commission consider characteristics such as the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults, as proposed? Why or why not? Are there particular other characteristics that the Commission should consider? If so, please explain the relevance of those characteristics in detail.
- Does the proposed rule sufficiently describe the types of factors that would be considered when the Commission considers a determination that a registered clearing agency is a covered clearing agency? What factors should be considered?
- Should the Commission, if it deems appropriate, determine whether a covered clearing agency is systemically important in multiple jurisdictions? Why or why not? If not, what alternative approach should the Commission use to assess whether a covered clearing agency is systemically important in multiple jurisdictions? For instance, what weight should the Commission give to determinations by other jurisdictions or regulators regarding the systemic importance in multiple jurisdictions of a covered clearing agency? Is it appropriate for the Commission to assess whether such determination was made through a process that includes consideration of whether the foreseeable effects of a failure or disruption of the designated clearing agency could threaten the stability of each relevant jurisdiction's financial system, as proposed? Please explain. Are there particular other factors that the Commission should consider? If so, please explain the relevance of those characteristics in detail.

- Does the proposed rule sufficiently describe the types of factors that would be considered when the Commission considers a determination that a covered clearing agency is systemically important in multiple jurisdictions? What factors should be considered?
- In determining whether any of the activities of a clearing agency providing CCP services have a more complex risk profile, should the Commission consider characteristics such as the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults, as proposed? Why or why not? Are there particular other characteristics that the Commission should consider? If so, please explain the relevance of those characteristics in detail.
- Does the proposed rule sufficiently describe the types of factors that would be considered when the Commission considers a determination that a clearing agency is a complex risk profile clearing agency? What factors should be considered?
- Does the proposed process for determinations under Rule 17Ab2-2 conflict with the PFMI Report's use of "systemic importance in multiple jurisdictions" and "more complex risk profile" activities? If so, please explain.

D. Proposed Rule 17Ad-22(f)

The Commission is proposing Rule 17Ad-22(f) to codify its special enforcement authority over designated clearing agencies for which the Commission acts as the supervisory agency, pursuant to the Clearing Supervision Act. Under Section 807(c) of the Clearing Supervision Act, for purposes of enforcing the provisions of the Clearing Supervision Act, a designated clearing agency is subject to, and the Commission has authority under, the provisions of subsections (b) through (n) of Section 8 of the Federal Deposit Insurance Act in the same manner and to the same extent as if a designated clearing agency were an insured depository institution and the Commission were the appropriate Federal banking agency for such insured depository institution.[388]

Request for Comments. The Commission requests comment on proposed Rule 17Ad-22(f), including whether the proposed rule is clear and consistent with the requirements of the Exchange Act and the Clearing Supervision Act.

E. Proposed Amendment to Rule 17Ad-22(d)

To facilitate consistency with proposed Rule 17Ad-22(e), the Commission is proposing to amend Rule 17Ad-22(d). Rule 17Ad-22(d) sets forth certain minimum requirements for the operation and governance of registered clearing agencies.[389] The first paragraph of Rule 17Ad-22(d) currently provides that a registered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to fulfill the requirements of Rule 17Ad-22(d), as applicable. The Commission is proposing to amend this first paragraph of Rule 17Ad-22(d) to state that Rule 17Ad-22(d) applies to registered clearing agencies other than covered clearing agencies.[390] As a result, the proposed amendment would limit the applicability of Rule 17Ad-22(d) to CME and ICE, as systemically important FMUs for which the CFTC is the supervisory agency under the Clearing Supervision Act,[391] the two registered but dormant

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388 See 12 U.S.C. 5466(c); see also 12 U.S.C. 1818 (relevant provisions under the Federal Deposit Insurance Act).

389 See 17 CFR 240.17Ad-22(d); see also Clearing Agency Standards Release, supra note 5, at 66244–58.

390 See proposed amendment to Rule 17Ad-22(d), infra Part VII.

391 See supra notes 84–87 and accompanying text.

clearing agencies,[392] and any clearing agency registered with the Commission in the future that is not one of the following: a designated clearing agency, a complex risk profile clearing agency, or a clearing agency that the Commission has otherwise determined to be a covered clearing agency pursuant to proposed Rule 17Ab2-2.[393]

Request for Comments. The Commission requests comment on the proposed amendment to Rule 17Ad-22(d), including whether the proposed amendment is clear and consistent with the requirements of the Exchange Act, the Clearing Supervision Act, and proposed Rule 17Ad-22(e) thereunder.

III. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA")[394] imposes certain requirements on federal agencies in connection with the conducting or sponsoring of any "collection of information."[395] More specifically, 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. Additionally, 44 U.S.C. 3507(a)(1)(D) provides that before adopting (or revising) a collection of information requirement, an agency must, among other things, publish a notice in the Federal Register stating that the agency has submitted the proposed collection of information to the Office of Management and Budget ("OMB") and setting forth certain required information, including (1) a title for the collection of information; (2) a summary of the collection information; (3) a brief description of the need for the information and the proposed

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392 See supra note 88 and accompanying text (discussing SCCP and BSECC).

393 See supra Part II.A.1 (further discussing the scope of the proposed rules).

394 44 U.S.C. 3501 et seq.

395 See 44 U.S.C. 3502(3).

use of the information; (4) a description of the likely respondents and proposed frequency of response to the collection of information; (5) an estimate of the paperwork burden that shall result from the collection of information; and (6) notice that comments may be submitted to the agency and director of OMB.[396]

Certain provisions of the proposed rules would impose new "collection of information" requirements within the meaning of the PRA. Accordingly, the Commission has submitted the information to the OMB for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. A title and control number already exists for Rule 17Ad-22 adopted in October 2012 (OMB Control No. 3235-0695 for "Clearing Agency Standards for Operation and Governance"). Because the Commission is proposing to revise the collection of information under this proposed rulemaking for amendments to Rule 17Ad-22, the Commission will use OMB Control No. 3235-0695 for the collections of information for proposed Rule 17Ad-22(e).

Additionally, proposed Rule 17Ab2-2 would contain a new collection of information requirement for PRA purposes. The title of the new collection of information under this proposed rulemaking is Determinations Affecting Covered Clearing Agencies (a proposed new collection of information).

A. Overview and Organization

The Commission preliminarily believes information that would be required to be collected by virtue of written policies and procedure requirements contained in this proposed rulemaking reflects to a degree existing practices at covered clearing agencies.[397] In certain instances, however, the proposed requirements would require covered clearing agencies to

396 See 44 U.S.C. 3507(a)(1)(D); see also 5 CFR 1320.5(a)(1)(iv).

397 See infra Part IV.B.3 (describing current practices at registered clearing agencies).

establish, implement, maintain and enforce written policies and procedures reasonably designed to comply with this proposed rulemaking.

With regard to proposed Rule 17Ad-22(e), given that several provisions of the proposed rule are intended to be consistent with Rule 17Ad-22, the Commission preliminarily believes that covered clearing agencies currently in compliance with the requirements of existing Rule 17Ad-22 may already have some written rules and procedures similar to those in proposed Rule 17Ad-22(e). Accordingly, when covered clearing agencies review and update their policies and procedures in order to come into compliance with proposed Rule 17Ad-22(e), the Commission preliminarily believes that the PRA burden would vary across the requirements of proposed Rule 17Ad-22(e), based on the complexities of the requirements under each paragraph of the proposed rule and the extent to which covered clearing agencies currently comply with the proposed requirements under their existing policies and procedures.[398]

The portions of proposed Rule 17Ad-22(e) for which the PRA burden is preliminarily expected to be higher are the provisions contemplating requirements not addressed in Rule 17Ad-22, as discussed in Part II.A.4. Because these proposed requirements may not reflect established practices of covered clearing agencies or reflect the normal course of their activities, the PRA burden for these proposed rules may entail both initial one-time burdens to create new written policies and procedures and ongoing burdens. The expected PRA burden for the proposed rules is discussed in detail below.[399]

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398 For a discussion of the differences between Rule 17Ad-22(d) and proposed Rule 17Ad-22(e), see Parts II.B.1–20.

399 See infra Parts III.D.6 (estimated burdens under proposed Rule 17Ad-22(e)(15)) and 7 (estimated burdens under proposed Rule 17Ad-22(e)(19)).

In addition to the collection of information requirements imposed under proposed Rule 17Ad-22(e), proposed Rule 17Ab2-2 also would contain collection of information requirements for PRA purposes. Proposed Rule 17Ab2-2 establishes a process for making determinations regarding whether or not a clearing agency would be a covered clearing agency and whether a covered clearing agency is either involved in activities with a more complex risk profile or systemically important in multiple jurisdictions.[400] The expected PRA burden for proposed Rule 17Ab2-2 is discussed below.

B. Summary of Collection of Information and Proposed Use of Information for Proposed Rule 17Ad-22(e)[401] and Proposed Rule 17Ab2-2

1. Proposed Rules 17Ad-22(e)(1) through (3): General Organization

a. Proposed Rule 17Ad-22(e)(1)

Proposed Rule 17Ad-22(e)(1) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.[402] The purpose of this collection of information is to reduce the legal risks involved in the clearance and settlement process and to ensure that a covered clearing agency's policies and procedures do not cause legal uncertainty among participants due to a lack of clarity, completeness, or conflicts with applicable laws and judicial precedent.

400 See infra Part II.C (further discussing the purpose, scope, and application of proposed Rule 17Ab2-2) and Part VII (proposed text of Rule 17Ab2-2).

401 Proposed Rule 17Ad-22(e) would require covered clearing agencies to establish, implement, maintain and enforce certain written policies and procedures that would be used, among other things, in connection with staff examinations.

402 See supra Part II.B.1 (discussing proposed Rule 17Ad-22(e)(1)) and infra Part VII (providing the proposed rule text).

b. **Proposed Rule 17Ad-22(e)(2)**

Proposed Rule 17Ad-22(e)(2) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent, clearly prioritize the safety and efficiency of the covered clearing agency, and support the public interest requirements of Section 17A of the Exchange Act, and the objectives of owners and participants. Proposed Rule 17Ad-22(e)(2) would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements reasonably designed to establish that the covered clearing agency's board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities.[403]

The purpose of this collection of information is to promote boards of directors that are composed of qualified members and that exercise oversight of the covered clearing agency's management, while also prioritizing the safety and efficiency of the covered clearing agency and supporting the public interest.

c. **Proposed Rule 17Ad-22(e)(3)**

Proposed Rule 17Ad-22(e)(3) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the covered clearing agency. Under the proposed rule, risk management policies,

403 See supra Part II.B.2 (discussing proposed Rule 17Ad-22(e)(2)) and infra Part VII (providing the proposed rule text).

procedures, and systems must provide for the identifying, measuring, monitoring, and managing of risks that arise in or are borne by the covered clearing agency. Such policies and procedures must be subject to review on a specified periodic basis and be approved by the board of directors annually. The proposed rule would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for plans for the recovery and orderly wind-down of the covered clearing agency in the event of credit losses, liquidity shortfalls, losses from general business risk, or any other losses. The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish that risk management and internal audit personnel have sufficient resources, authority, and independence from management. The proposed rule would further require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish that risk management and internal audit personnel have a direct reporting line to, and are overseen by, a risk management committee and an audit committee of the board of directors, respectively. The proposed rule would also require policies and procedures providing for an independent audit committee.[404]

The purpose of this collection of information is to enhance a covered clearing agency's ability to identify, monitor, and manage the risks clearing agencies face, including by subjecting the relevant policies and procedures to regular review, and to facilitate an orderly recovery and wind-down process in the event that a covered clearing agency is unable to continue operating as a going concern.

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404 See supra Part II.B.3 (discussing proposed Rule 17Ad-22(e)(3)) and infra Part VII (providing the proposed rule text).

2. Proposed Rules 17Ad-22(e)(4) through (7): Financial Risk Management

a. Proposed Rule 17Ad-22(e)(4)

Proposed Rule 17Ad-22(e)(4) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to each participant and those exposures arising from payment, clearing, and settlement processes. Proposed Rule 17Ad-22(e)(4)(i) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to cover its credit exposure to each member fully with a high degree of confidence. To the extent not already maintained pursuant to proposed Rule 17Ad-22(e)(4)(i), a covered clearing agency that provides CCP services would also have to establish, implement, maintain, and enforce written policies and procedures to meet either the "cover one" requirement under proposed Rule 17Ad-22(e)(4)(iii) or, if it is a complex risk profile clearing agency or systemically important in multiple jurisdictions, the "cover two" requirement under proposed Rule 17Ad-22(e)(4)(ii).

Proposed Rule 17Ad-22(e)(4)(iv) would require covered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures by including prefunded financial resources and excluding assessments for additional guaranty fund contributions or other resources that are not prefunded, when calculating financial resources available to meet the requirements under proposed Rules 17Ad-22(e)(4)(i) through (iii), as applicable.[405]

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405 See supra Part II.B.4.c (discussing proposed Rule 17Ad-22(e)(4)) and infra Part VII (providing the proposed rule text).

Proposed Rule 17Ad-22(e)(4)(v) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain the financial resources required under proposed Rules 17Ad-22(e)(4)(i) through (iii), as applicable, in combined or separately maintained clearing or guaranty funds, and to test the sufficiency of its total financial resources by conducting a stress test of total financial resources once each day using standard predetermined parameters and assumptions.

Proposed Rule 17Ad-22(e)(4)(vi) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to test the sufficiency of its total financial resources available to meet the minimum financial resource requirements under proposed Rules 17Ad-22(e)(4)(i) through (iii), as applicable, by conducting stress tests and other comprehensive analyses. Specifically, those would include conducting a stress test of its total financial resources once each day using standard predetermined parameters and assumptions. It would also include conducting a comprehensive analysis on at least a monthly basis of the existing stress testing scenarios, models, and underlying parameters and assumptions, and considering modifications to ensure that they are appropriate for determining the covered clearing agency's required level of default protection in light of current market conditions. It would also include conducting a comprehensive analysis of stress testing scenarios, models, and underlying parameters and assumptions more frequently than monthly when the products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by its participants increases significantly. It would also include reporting the results of this analysis to appropriate decision makers, including its risk management committee or board of directors, and to use these results to evaluate the adequacy of and adjust its margin methodology, model parameters, models used to generate clearing or guaranty fund requirements, and any other relevant aspects of its credit risk management policies and procedures, in supporting compliance with the minimum financial resources requirements discussed above.

Finally, proposed Rule 17Ad-22(e)(4)(vii) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require the covered clearing agency to perform a conforming model validation for its credit risk models at least annually, or more frequently if dictated by the covered clearing agency's risk management policies and procedures established under proposed Rule 17Ad-22(e)(3).[406]

b. Proposed Rule 17Ad-22(e)(5)

Rule 17Ad-22(e)(5) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to limit the assets it accepts as collateral to those with low credit, liquidity, and market risks. It also would require policies that set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its or its participants' credit exposure and would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require a not-less-than-annual review of the sufficiency of its collateral haircut and concentration limits.[407]

c. Proposed Rule 17Ad-22(e)(6)

Proposed Rule 17Ad-22(e)(6) would require a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures

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406 See id.

407 See supra Part II.B.4.d (discussing proposed Rule 17Ad-22(e)(5)) and infra Part VII (providing the proposed rule text).

reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system. The proposed rule would require such margin system to consider, and produce margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market. Furthermore, under the proposed rule the margin system would mark participant positions to market and collect margin, including variation margin or equivalent charges if relevant, at least daily, and include the authority and operational capacity to make intraday margin calls in defined circumstances. The proposed rule also requires policies and procedures with respect to the following: the calculation of margin sufficient to cover a covered clearing agency's potential future exposure to participants in the interval between the last margin collection and close out of positions following a participant default; the use of reliable sources of timely price data and procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable; and the use of an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.[408]

In addition to requiring policies and procedures with respect to a risk-based margin system, proposed Rule 17Ad-22(e)(6) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to regularly review, test, and verify risk-based margin systems by conducting backtests at least once each day and, at least monthly, a conforming sensitivity analysis of its margin resources and its parameters and assumptions for backtesting, and consider modifications to ensure the backtesting practices are appropriate for determining the adequacy of its margin resources. Such review,

408 See supra Part II.B.4.e (discussing proposed Rule 17Ad-22(e)(6)) and infra Part VII (providing the proposed rule text).

testing, and verification would include conducting a conforming sensitivity analysis more frequently than monthly when the products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by participants increase or decrease significantly. The proposed rule would also require a covered clearing agency providing CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to report the results of such conforming sensitivity analysis to appropriate decision makers, including its risk management committee or board of directors, and use these results to evaluate the adequacy of and adjust its margin methodology, model parameters, and any other relevant aspects of its credit risk management policies and procedures. Finally, under such policies and procedures, a not less than annual conforming model validation would be required for the covered clearing agency's margin system and related models.[409]

d. Proposed Rule 17Ad-22(e)(7)

Proposed Rule 17Ad-22(e)(7) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis and its use of intraday liquidity. Under the proposed rule, a covered clearing agency would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that includes the default of the participant family that would generate

409 See id.

the largest aggregate payment obligation for it in extreme but plausible market conditions. Under such policies and procedures, use of access to accounts and services at a Federal Reserve Bank, pursuant to Section 806 of the Clearing Supervision Act,[410] or other relevant central bank, when available and where determined to be practical by the board of directors of the covered clearing agency, would be required.[411]

For the purposes of meeting such liquid resource requirements, a covered clearing agency would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to require the holding of qualifying liquid resources in each relevant currency for which clearing activities are performed, limited to (i) cash at the central bank of issue or at creditworthy commercial banks; (ii) assets that are readily available and convertible into cash through prearranged funding arrangements without material adverse change provisions, such as committed lines of credit, committed foreign exchange swaps, committed repurchase agreements, and other prearranged funding arrangements determined to be highly reliable even in extreme but plausible market conditions by the board of directors, following an annual review conducted for this purpose; and (iii) other assets that are readily available and eligible for pledging to (or conducting other appropriate forms of transactions with) a relevant central bank, provided that the covered clearing agency had access to routine credit at the central bank.

With respect to a covered clearing agency's sources of liquidity, the proposed rule would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to undertake due diligence to confirm that it has a

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410 12 U.S.C. 5465(a).

411 See supra Part II.B.4.f (discussing proposed Rule 17Ad-22(e)(7)) and infra Part VII (providing the proposed rule text).

reasonable basis to believe each of its liquidity providers, whether or not such liquidity provider is a clearing member, has sufficient information to understand and manage the liquidity provider's liquidity risks, and the capacity to perform as required under its commitments to provide liquidity. Furthermore, under such policies and procedures, on at least an annual basis, a covered clearing agency would be required to maintain and test with each liquidity provider to the extent practicable the covered clearing agency's procedures and operational capacity for accessing each type of liquidity resource by conducting stress testing of its liquidity resources using standard and predetermined parameters and assumptions at least once each day. Additionally, a covered clearing agency would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to determine the amount and regularly test the sufficiency of the liquid resources held for purposes of meeting the minimum liquid resource requirement by (i) conducting a stress test of its liquidity resources using standard and predetermined parameters and assumptions at least once each day; and (ii) conducting a comprehensive analysis of the existing stress testing scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources, and considering modifications to ensure they are appropriate in light of current and evolving market conditions at least once a month and more frequently when products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by participants increase significantly.[412]

Under such policies and procedures required by the proposed rule, stress test results must be reported to appropriate decision makers, including the risk management committee or board of directors, at the covered clearing agency for use in evaluating the adequacy of and adjusting

412 See id.

its liquidity risk management policies and procedures. A covered clearing agency would also be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to perform an annual conforming model validation of its liquidity risk models and would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to address foreseeable liquidity shortfalls that would not be covered by its liquid resources and to seek to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations. Additionally, a covered clearing agency would be required to establish, implement, maintain and enforce written policies and procedures that describe the covered clearing agency's process to replenish any liquid resources that may be employed during a stress event.[413]

Finally, a covered clearing agency would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to require the covered clearing agency to undertake an analysis at least once a year that evaluates the feasibility of maintaining sufficient liquid resources at a minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions if the covered clearing agency provides central counterparty services and is either systemically important in multiple jurisdictions or a clearing agency involved in activities with a more complex risk profile.

413 See id.

The purpose of this information collection is to enable a covered clearing agency to be able to effectively identify and limit exposures to participants, to maintain sufficient collateral or margin, and to satisfy all of its settlement obligations in the event of a participant default.

3. Proposed Rules 17Ad-22(e)(8) through (10): Settlement

a. Proposed Rule 17Ad-22(e)(8)

Proposed Rule 17Ad-22(e)(8) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to define the point at which settlement is final no later than the end of the day on which the payment or obligation is due and, where necessary or appropriate, either intraday or in real time.[414]

b. Proposed Rule 17Ad-22(e)(9)

Proposed Rule 17Ad-22(e)(9) would require covered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to have the covered clearing agency conduct its money settlements in central bank money, where available and determined to be practical by the board of directors of the covered clearing agency, and minimize and manage credit and liquidity risk arising from the clearing agency's money settlements in commercial bank money where central bank money is not used.[415]

c. Proposed Rule 17Ad-22(e)(10)

Proposed Rule 17Ad-22(e)(10) would require a covered clearing agency to establish, implement, maintain and enforce written policies reasonably designed to set forth transparent written standards regarding a clearing agency's obligations with respect to the delivery of

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414 See supra Part II.B.5 (discussing proposed Rule 17Ad-22(e)(8)) and infra Part VII (providing the proposed rule text).

415 See supra Part II.B:6 (discussing proposed Rule 17Ad-22(e)(9)) and infra Part VII (providing the proposed rule text).

physical instruments, as well as operational practices that identify, monitor, and manage the risk associated with such physical deliveries.[416]

The purpose of this information collection is to promote consistent standards of timing and reliability in the settlement process, promote reliability in a covered clearing agency's settlement operations, and to provide a covered clearing agency's participants with information necessary to evaluate the risks and costs associated with participation in the covered clearing agency.

4. Proposed Rules 17Ad-22(e)(11) through (12): CSDs and Exchange-of-Value Settlement Systems

The purpose of this collection of information is to reduce securities transfer processing costs and risks associated with securities settlement and custody, increase the speed and efficiency of the settlement process, and eliminate risk in transactions with linked obligations.

a. Proposed Rule 17Ad-22(e)(11)

Proposed Rule 17Ad-22(e)(11) would require a covered CSD to establish, implement, maintain and enforce written policies and procedures reasonably designed to implement internal auditing and other controls to safeguard the rights of securities issuers and holders and prevent the unauthorized creation or deletion of securities. A covered CSD would also be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to conduct periodic and at least daily reconciliation of securities issues that the CSD maintains. Additionally, the proposed rule would require a covered CSD to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain securities in an immobilized or dematerialized form, ensure the integrity of securities issues, and minimize and

416 See supra Part II.B.7 (discussing proposed Rule 17Ad-22(e)(10)) and infra Part VII (providing the proposed rule text).

manage the risks associated with the safekeeping and transfer of securities, as well as protect assets against custody risk.[417]

b. Proposed Rule 17Ad-22(e)(12)

Proposed Rule 17Ad-22(e)(12) would require a covered clearing agency that settles transactions involving the settlement of two linked obligations to establish, implement, maintain and enforce written policies and procedures reasonably designed to eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other, irrespective of whether the covered clearing agency settles on a gross or net basis and when finality occurs.[418]

5. Proposed Rules 17Ad-22(e)(13) through (14): Default Management

The purpose of this collection of information is to facilitate the functioning of a covered clearing agency in the event that a participant fails to meet its obligations, as well as limit the extent to which a participant's failure can spread to other participants or the covered clearing agency itself, and to ensure the safe and effective holding and transfer of customers' positions and collateral in the event of a participant's default or insolvency.

a. Proposed Rule 17Ad-22(e)(13)

Proposed Rule 17Ad-22(e)(13) would require covered clearing agencies providing CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that a covered clearing agency subject to this rule has sufficient

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417 See supra Part II.B.8 (discussing proposed Rule 17Ad-22(e)(11)) and infra Part VII (providing the proposed rule text).

418 See supra Part II.B.9 (discussing proposed Rule 17Ad-22(e)(12)) and infra Part VII (providing the proposed rule text).

authority and operational capability to contain losses and liquidity demands in a timely fashion and continue to meet its own obligations. The proposed rule would also require that a covered clearing agency subject to the rule establish, implement, maintain and enforce written policies and procedures reasonably designed to address the allocation of credit losses it may face if its collateral or other resources are insufficient to fully cover its credit exposures, describe the process whereby the clearing agency would replenish any financial resources it may use following a default or other event in which the use of such resources is contemplated, and require participants and other stakeholders, to the extent applicable, to participate in the testing and review of its default procedures, including any close out procedures. Under such policies and procedures, the testing and review must occur at least annually and following any material changes thereto.[419]

b. Proposed Rule 17Ad-22(e)(14)

Proposed Rule 17Ad-22(e)(14) would require a covered clearing agency that provides CCP services for security-based swaps or engages in activities that the Commission has determined to have a more complex risk profile to establish, implement, maintain and enforce written policies and procedures reasonably designed to enable the segregation and portability of positions of a participant's customers and collateral and effectively protect such positions and collateral from the default or insolvency of that participant.[420]

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419 See supra Part II.B.10 (discussing proposed Rule 17Ad-22(e)(13)) and infra Part VII (providing the proposed rule text).

420 See supra Part II.B.11 (discussing proposed Rule 17Ad-22(e)(14)) and infra Part VII (providing the proposed rule text).

6. Proposed Rules 17Ad-22(e)(15) through (17): General Business and Operational Risk Management

The purpose of this collection of information is to mitigate the potential impairment of a covered clearing agency as a result of a decline in revenues or increase in expenses, to limit disruptions that may impede the proper functioning of a covered clearing agency, and to improve the ability of a covered clearing agency to meet its settlement obligations.

a. Proposed Rule 17Ad-22(e)(15)

Proposed Rule 17Ad-22(e)(15) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if losses materialize. Covered clearing agencies would also be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to determine the amount of liquid net assets funded by equity based upon the general risk profile of that clearing agency and the length of time necessary to achieve recovery or orderly wind-down. The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to hold liquid net assets funded by equity in an amount equal to the greater of either six months of current operating expenses or the amount determined by the agency's board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services. Under such policies and procedures, these resources are to be held in addition to resources held to cover participant default or other risks and must be of high quality and sufficiently liquid. Furthermore, under such policies and procedures, a covered clearing agency would be required to maintain a viable plan for raising additional equity in the event that its equity falls close to, or below, the required amount, and the plan would be required to be approved by the board of directors and updated at least annually.[421]

b. Proposed Rule 17Ad-22(e)(16)

Proposed Rule 17Ad-22(e)(16) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to safeguard its own assets, as well as the assets of its participants, and to minimize the risk of loss and delay in access to such assets. A covered clearing agency would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to invest such assets in instruments with minimal credit, market and liquidity risks.[422]

c. Proposed Rule 17Ad-22(e)(17)

Proposed Rule 17Ad-22(e)(17) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to manage operational risk. A covered clearing agency would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. A covered clearing agency would also be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity. The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures

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421 See supra Part II.B.12 (discussing proposed Rule 17Ad-22(e)(15)) and infra Part VII (providing the proposed rule text).

422 See supra Part II.B.13 (discussing proposed Rule 17Ad-22(e)(16)) and infra Part VII (providing the proposed rule text).

reasonably designed to establish and maintain a business continuity plan that addresses events posing a significant risk of disrupting operations.[423]

7. Proposed Rules 17Ad-22(e)(18) through (20): Access

The purpose of the collection of information is to enable a covered clearing agency to ensure that only entities with sufficient financial and operational capacity are direct participants in the covered clearing agency while ensuring that all qualified persons can access a covered clearing agency's services; to enable a covered clearing agency to monitor that participation requirements are met on an ongoing basis and to identify a participant experiencing financial difficulties before the participant fails to meet its settlement obligations; and to enable a covered clearing agency to identify and manage risks posed by non-member entities.

a. Proposed Rule 17Ad-22(e)(18)

Proposed Rule 17Ad-22(e)(18) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other FMUs, and require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency. A covered clearing agency would also be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to monitor compliance with such participation requirements on an ongoing basis.[424]

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423 See supra Part II.B.14 (discussing proposed Rule 17Ad-22(e)(17)) and infra Part VII (providing the proposed rule text).

424 See supra Part II.B.15 (discussing proposed Rule 17Ad-22(e)(18)) and infra Part VII (providing the proposed rule text).

b. Proposed Rule 17Ad-22(e)(19)

Proposed Rule 17Ad-22(e)(19) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage the material risks to the covered clearing agency arising from arrangements in which firms that are indirect participants rely on services provided by direct participants to access the covered clearing agency's payment, clearing, or settlement facilities.[425]

c. Proposed Rule 17Ad-22(e)(20)

Proposed Rule 17Ad-22(e)(20) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link with one or more other clearing agencies, FMUs, or trading markets.[426]

8. Proposed Rules 17Ad-22(e)(21) through (22): Efficiency

The purpose of this collection of information is to ensure that the services provided by a covered clearing agency do not become inefficient and to promote the sound operation of a covered clearing agency. The collection of information is also intended to ensure the prompt and accurate clearance and settlement of securities transactions by enabling participants to communicate with a clearing agency in a timely, reliable, and accurate manner.

a. Proposed Rule 17Ad-22(e)(21)

Proposed Rule 17Ad-22(e)(21) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require

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425 See supra Part II.B.16 (discussing proposed Rule 17Ad-22(e)(19)) and infra Part VII (providing the proposed rule text).

426 See supra Part II.B.17 (discussing proposed Rule 17Ad-22(e)(20)) and infra Part VII (providing the proposed rule text).

the covered clearing agency to be efficient and effective in meeting the requirements of its participants and the markets it serves. Additionally, the rule would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to have the management of a covered clearing agency regularly review the efficiency and effectiveness of the covered clearing agency's (i) clearing and settlement arrangement; (ii) operating structure, including risk management policies, procedures, and systems; (iii) scope of products cleared, settled, or recorded; and (iv) use of technology and communications procedures.[427]

b. Proposed Rule 17Ad-22(e)(22)

Proposed Rule 17Ad-22(e)(22) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to use, or at a minimum, accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, and settlement.[428]

9. Proposed Rule 17Ad-22(e)(23): Disclosure

Proposed Rule 17Ad-22(e)(23) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain clear and comprehensive rules and procedures that provide for (i) publicly disclosing all relevant rules and material procedures, including key aspects of default rules and procedures; (ii) providing sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs incurred by participating in a covered clearing agency; and (iii) publicly

427 See supra Part II.B.18 (discussing proposed Rule 17Ad-22(e)(21)) and infra Part VII (providing the proposed rule text).

428 See supra Part II.B.19 (discussing proposed Rule 17Ad-22(e)(22)) and infra Part VII (providing the proposed rule text).

disclosing relevant basic data on transaction volume and values. The proposed rule would also require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain clear and comprehensive rules and procedures that provide for a comprehensive public disclosure of its material rules, policies, and procedures regarding governance arrangements and legal, financial, and operational risk management that is accurate in all material respects at the time of publication and to update this public disclosure every two years, or more frequently following changes to the clearing agency's system or the environment in which it operates to the extent necessary to ensure that previous statements remain accurate in all material respects.[429] The purpose of the collection of information is to ensure that participants, as well as prospective participants, are provided with a complete picture of the covered clearing agency's operations and risk mitigation procedures in order to be able to fully and clearly understand the risks and responsibilities of participation in a clearing agency.

10. Proposed Rule 17Ab2-2

Proposed Rule 17Ab2-2 establishes a process for making determinations regarding whether a clearing agency is a covered clearing agency and whether a covered clearing agency is either involved in activities with a more complex risk profile or systemically important in multiple jurisdictions.[430] Each of these determinations may be initiated by a registered clearing agency, a member of the clearing agency, or upon the Commission's own initiative.[431] In each case, under proposed Rule 17Ab2-2(d), the Commission would publish notice of its intention to

[429] See supra Part II.B.20 (discussing proposed Rule 17Ad-22(e)(23)) and infra Part VII (providing the proposed rule text).

[430] See infra Part II.C (further discussing the purpose, scope, and application of proposed Rule 17Ab2-2) and Part VII (proposed text of Rule 17Ab2-2).

[431] See proposed Rule 17Ab2-2(a), infra Part VII.

consider such determinations, together with a brief statement of the grounds under consideration, and provide at least a 30-day public comment period prior to any determination. Under proposed Rule 17Ab2-2(e), notice of determinations in each case would be given prompt publication by the Commission, together with a statement of written reasons supporting the determination.

C. Respondents

The Commission estimates that the majority of the proposed requirements under proposed Rule 17Ad-22(e) would apply to five registered clearing agencies. The proposed requirements in proposed Rules 17Ad-22(e)(1) through (23) would impose a PRA burden on covered clearing agencies. A covered clearing agency is defined under proposed Rule 17Ad-22(a)(7) as any designated clearing agency, clearing agency involved in activities with a more complex risk profile for which the CFTC is not the supervisory agency as defined in Section 803(8) of the Clearing Supervision Act, or a clearing agency determined by the Commission to be a covered clearing agency pursuant to proposed Rule 17Ab2-2.[432] A designated clearing agency is defined under proposed Rule 17Ad-22(a)(8) as a registered clearing agency that has been designated systemically important by the FSOC.[433] The FSOC has designated six registered clearing agencies as systemically important.[434] The Commission is the supervisory agency with respect to four of these designated clearing agencies, and the CFTC is the

432 See proposed Rule 17Ad-22(a)(7), infra Part VII; see also supra Part II.A.1 (describing the scope of proposed Rule 17Ad-22(e) and defining "covered clearing agency").

433 See proposed Rule 17Ad-22(a)(8), infra Part VII; see also supra Part II.A.1 (describing the scope of proposed Rule 17Ad-22(e) and defining "designated clearing agency"); supra Part I.B.2 (describing designation as systemically important by the FSOC under the Clearing Supervision Act).

434 See supra note 38 and accompanying text.

supervisory agency for the remaining two.[435] Accordingly, proposed Rule 17Ad-22(e) would apply to the four designated clearing agencies for which the Commission is the supervisory agency.[436]

In addition to the four designated clearing agencies for which the Commission is the supervisory agency, a fifth clearing agency would also be subject to the proposed rules as a complex risk profile clearing agency that provides CCP services for security-based swaps for which the CFTC is not the supervisory agency under the Clearing Supervision Act.[437]

While the proposed rules would be applicable to the five registered clearing agencies currently captured by the definition of covered clearing agency, the Commission estimates that two additional entities may seek to register with the Commission and that one of these entities may seek to register in order to provide CCP services for security-based swaps. Upon registration, these two entities may be deemed covered clearing agencies and would be subject to proposed Rule 17Ad-22(e).

The number of covered clearing agencies subject to proposed Rule 17Ad-22(e) could increase if the FSOC designates additional clearing agencies as systemically important.[438] Additionally, the Commission could determine additional clearing agencies to be covered clearing agencies under proposed Rule 17Ab2-2,[439] subjecting them to the provisions of

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435 See supra note 41 and accompanying text.

436 See supra notes 82, 84–87, and accompanying text.

437 See supra note 83 and accompanying text.

438 See supra Part I.B.2, in particular notes 27–28, 38–41, and accompanying text.

439 See supra Part II.C (discussing the purpose, scope, and application of proposed Rule 17Ab2-2) and Part VII (proposed text of Rule 17Ab2-2).

proposed Rule 17Ad-22(e). While the number of clearing agencies subject to proposed Rule 17Ad-22(e) could increase, the Commission is not able to predict whether the FSOC will exercise its authority in the future to designate additional clearing entities as systemically important FMUs or whether the Commission will determine additional clearing agencies to be covered clearing agencies. As a result, for the purposes of the PRA analysis, the Commission is preliminarily estimating that there would be seven respondents for a majority of the proposed requirements under proposed Rule 17Ad-22(e). With regard to proposed Rule 17Ad-22(e)(6), the number of respondents would be six because the proposed rule would apply to covered clearing agencies that provide CCP services. With regard to proposed Rule 17Ad-22(e)(11), the number of respondents would be one because the proposed rule would apply to covered clearing agencies that provide CSD services. With regard to proposed Rule 17Ad-22(e)(14), the number of respondents would be two because the proposed rule would apply to covered clearing agencies that provide CCP services for security-based swaps.

With regard to proposed Rule 17Ab2-2, the Commission preliminarily estimates for purposes of the PRA analysis that two registered clearing agencies or their members on their behalf will apply for a Commission determination, or may be subject to a Commission-initiated determination, regarding whether the registered clearing agency is a covered clearing agency, whether a registered clearing agency is involved in activities with a more complex risk profile, or whether a covered clearing agency is systemically important in multiple jurisdictions.

D. Total Annual Reporting and Recordkeeping Burden for Proposed Rule 17Ad-22(e)

The Commission preliminarily believes that the potential PRA burden imposed by the requirements under proposed Rule 17Ad-22(e) will vary depending on the requirement in question because registered clearing agencies are subject to existing requirements under Rule

17Ad-22 that, in some cases, are similar to those in proposed Rule 17Ad-22(e), as discussed in Part II.

First, because proposed Rules 17Ad-22(e)(1), (8) through (10), (12), (14),[440] (16), and (22)[441] contain requirements that are either substantially similar to those under existing Rule 17Ad-22 or have current practices that the Commission understands largely conform with the proposed rules, the Commission preliminarily believes that covered clearing agencies may need to make only limited changes to update their policies and procedures to satisfy these proposed requirements. In these cases, as an example, a covered clearing agency may need to conduct a review of the proposed rule against its existing policies and procedures to confirm that it satisfies the proposed requirements.[442]

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440 In the case of proposed Rule 17Ad-22(e)(14), the Commission preliminarily believes that the current practices of covered clearing agencies already largely conform to the proposed requirement, and accordingly believes that covered clearing agencies may need to make only limited changes to update their policies and procedures pursuant to the proposed rule. See infra note 508 and accompanying text; see also infra Parts IV.B.3.e.ii and IV.C.3.a.ix (discussing the current practices at registered clearing agencies regarding segregation and portability and the anticipated economic effect of the proposed rule, respectively).

441 In the case of proposed Rule 17Ad-22(e)(22), the Commission preliminarily believes that the current practices of covered clearing agencies already largely conform to the proposed requirement, and accordingly believes that covered clearing agencies may need to make only limited changes to update their policies and procedures pursuant to the proposed rule. See supra Part II.B.19 (discussing the requirements under the proposed rule) and infra Parts IV.B.3.h.ii and IV.C.3.a.xv (discussing the current practices at registered clearing agencies regarding communication procedures and standards and the anticipated economic effect of the proposed rule, respectively).

442 In this regard, the Commission notes that its estimates for the initial one-time and ongoing burdens for proposed Rules 17Ad-22(e)(8) through (10) and (12) are the same across each of the proposed rules because the Commission preliminarily believes that the burdens associated with each would primarily constitute a review of the covered clearing agency's policies and procedures to confirm that those policies and procedures satisfy the proposed requirement.

Second, because proposed Rules 17Ad-22(e)(2), (3), (5), (11), (13), (17), (18), (20), and (21) contain provisions that are similar to those under existing Rule 17Ad-22 but would impose additional requirements that do not appear in existing Rule 17Ad-22, the Commission preliminarily believes that covered clearing agencies may need to make changes to update their policies and procedures to satisfy the proposed requirements. In these cases, as an example, a covered clearing agency may need to review and amend its existing rule book, policies, and procedures but may not need to develop, design, or implement new operations and practices to satisfy the proposed requirements.

Third, for proposed Rules 17Ad-22(e)(4), (6), (7), (15), (19), and (23), for which no similar existing requirements under Rule 17Ad-22 have been identified,[443] the Commission preliminarily believes that covered clearing agencies may need to make more extensive changes to their policies and procedures (or implement new policies and procedures), and may need to take other steps to satisfy the proposed requirements. In these cases, the PRA burden would be greater since a covered clearing agency may need to, as an example, develop, design, and implement new operations and practices. With respect to these provisions, the PRA burden may be greater since these proposed requirements may not reflect established practices of covered clearing agencies or reflect the normal course of their activities, and the PRA burden for these proposed rules may therefore entail initial one-time burdens to create new written policies and procedures and ongoing burdens, including burdens associated with disclosure requirements.

443 In the case of Rule 17Ad-22(e)(23), registered clearing agencies are subject to existing requirements for disclosure under existing Rule 17Ad-22, but new requirements under the proposed rule would impose greater burdens relative to other proposed rules that have similar requirements to those under existing Rule 17Ad-22. See supra Part II.B.20 (discussing the requirements under proposed Rule 17Ad-22(e)(23) and their relationship to requirements under existing Rule 17Ad-22(d)(9)).

The Commission requests comment regarding the accuracy of the estimates discussed below.

1. Proposed Rules 17Ad-22(e)(1) through (3): General Organization

a. Proposed Rule 17Ad-22(e)(1)

Proposed Rule 17Ad-22(e)(1) contains substantially the same requirements as Rule 17Ad-22(d)(1).[444] As a result, a respondent clearing agency would already have written rules, policies, and procedures substantially similar to the requirements that would be imposed under the proposed rule. The PRA burden imposed by the proposed rules would therefore be minimal and would likely be limited to the review of current policies and procedures and updating existing policies and procedures where appropriate in order to ensure compliance with the proposed rule. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(1),[445] the Commission preliminarily believes that respondent clearing agencies would incur an aggregate one-time burden of approximately 56 hours to review and update existing policies and procedures.[446]

Proposed Rule 17Ad-22(e)(1) would also impose ongoing burdens on a respondent clearing agency. The proposed rule would require ongoing monitoring and compliance activities

444 See 17 CFR 240.17Ad-22(d)(1); proposed Rule 17Ad-22(e)(1), infra Part VII; see also supra Part II.B.1 (discussing the requirements under the proposed rule).

445 See Clearing Agency Standards Release, supra note 5, at 66260.

446 This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours)) = 8 hours x 7 respondent clearing agencies = 56 hours.

with respect to the written policies and procedures created in response to the proposed rule.[447] Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[448] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(1) would impose an aggregate annual burden on respondent clearing agencies of 21 hours.[449]

b. Proposed Rule 17Ad-22(e)(2)

Proposed Rule 17Ad-22(e)(2) contains some provisions that are similar to Rule 17Ad-22(d)(8), but also adds additional requirements that do not appear in existing Rule 17Ad-22.[450] As a result, a respondent clearing agency is required to have some written rules, policies, and procedures substantially similar to the requirements that would be imposed under proposed Rule 17Ad-22(e)(2) and would need to establish and implement a limited number of new policies and procedures. The PRA burden imposed by the proposed rule would therefore be associated with reviewing current policies and procedures and updating those policies and procedures or establishing new policies and procedures, where appropriate, in order to ensure compliance with the proposed rule. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-

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447 Where the Commission refers to anticipated burdens related to "enforcement activities," the Commission notes that such policies and procedures contemplate enforcement by the respondent clearing agency itself. See Clearing Agency Standards Release, supra note 5, at 66246 (stating that "the clearing agency must be able to enforce its policies and procedures that contemplate enforcement by the clearing agency").

448 See Clearing Agency Standards Release, supra note 5, at 66260–63.

449 This figure was calculated as follows: (Compliance Attorney for 3 hours) x 7 respondent clearing agencies = 21 hours.

450 See 17 CFR 240.17Ad-22(d)(8); proposed Rule 17Ad-22(e)(2), infra Part VII; see also supra Part II.B.2 (discussing the requirements under the proposed rule).

22(d)(8),[451] the Commission preliminarily believes that respondent clearing agencies would incur an aggregate one-time burden of approximately 154 hours to review and update existing policies and procedures and to create new policies and procedures, as necessary.[452]

Proposed Rule 17Ad-22(e)(2) would also impose ongoing burdens on a respondent clearing agency. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[453] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(2) would impose an aggregate annual burden on respondent clearing agencies of 28 hours.[454]

c. Proposed Rule 17Ad-22(e)(3)

Proposed Rule 17Ad-22(e)(3) would require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a sound risk management framework.[455] Under Rule 17Ad-22(d), registered clearing agencies are required to have policies and procedures to manage certain risks faced by these

451 See Clearing Agency Standards Release, supra note 5, at 66260.

452 This figure was calculated as follows: ((Assistant General Counsel for 24 hours) + (Compliance Attorney for 10 hours)) = 22 hours x 7 respondent clearing agencies = 154 hours.

453 See Clearing Agency Standards Release, supra note 5, at 66260–63.

454 This figure was calculated as follows: (Compliance Attorney for 4 hours) x 7 respondent clearing agencies = 28 hours.

455 See proposed Rule 17Ad-22(e)(3), infra Part VII.

entities,[456] but the proposed rule would require a comprehensive framework for risk management that would require risk management policies and procedures be designed holistically, be consistent with each other, and work effectively together. Accordingly, the proposed rule may impose a PRA burden that would require respondent clearing agencies to update current policies and procedures in order to develop a more comprehensive framework that would include a periodic review thereof and a plan for orderly recovery and wind-down of the covered clearing agency. As a result, the Commission preliminarily estimates that respondent clearing agencies would incur an aggregate one-time burden of 399 hours to review and update existing policies and procedures and to create new policies and procedures, as necessary.[457]

Proposed Rule 17Ad-22(e)(3) would also impose ongoing burdens on a respondent clearing agency. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule and activities related to preparing documents facilitating a periodic review of the risk management framework. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[458] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(3) would impose an

456 See 17 CFR 240.17Ad-22(d); see also Part II.B.3 (discussing the requirements under the proposed rule and their relationship to existing requirements under Rule 17Ad-22).

457 This figure was calculated as follows: ((Assistant General Counsel for 25 hours) + (Compliance Attorney for 18 hours) + (Senior Risk Management Specialist for 7 hours) + (Computer Operations Manager for 7 hours)) = 57 hours x 7 respondent clearing agencies = 399 hours.

458 See Clearing Agency Standards Release, supra note 5, at 66260–63.

aggregate annual burden on respondent clearing agencies of 343 hours.[459] The Commission notes that the estimated ongoing burden for Proposed Rule 17Ad-22(e)(3) is similar to the initial one-time burden because the proposed rule includes a specific requirement that policies and procedures for comprehensive risk management include review on a specified periodic basis and approval by the board of directors annually.

2. Proposed Rules 17Ad-22(e)(4) through (7): Financial Risk Management

a. Proposed Rule 17Ad-22(e)(4)

The Commission preliminarily believes that the estimated PRA burdens for proposed Rule 17Ad-22(e)(4) would be more significant, as changes to existing policies and procedures would involve more than adjustments and may require a respondent clearing agency to make substantial changes to its policies and procedures.[460] In addition, proposed Rule 17Ad-22(e)(4) would require one-time systems adjustments related to the capability to test the sufficiency of financial resources and to perform an annual conforming model validation. As a result, the Commission preliminarily estimates that respondent clearing agencies would incur an aggregate one-time burden of 1,400 hours.[461]

Proposed Rule 17Ad-22(e)(4) would also impose ongoing burdens on a respondent clearing agency. The proposed rule would require ongoing monitoring and compliance activities

459 This figure was calculated as follows: ((Compliance Attorney for 8 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 5 hours) + (Risk Management Specialist for 33 hours)) = 49 hours x 7 respondent clearing agencies = 343 hours.

460 See proposed Rule 17Ad-22(e)(4), infra Part VII; see also supra Part II.B.4.c (discussing the requirements under the proposed rule).

461 This figure was calculated as follows: ((Assistant General Counsel for 60 hours) + (Compliance Attorney for 40 hours) + (Senior Risk Management Specialist for 30 hours) + (Computer Operations Manager for 45 hours) + (Chief Compliance Officer for 15 hours) + (Senior Programmer for 10 hours)) = 200 hours x 7 respondent clearing agencies = 1,400 hours.

with respect to the written policies and procedures created in response to the proposed rule and ongoing activities with respect to testing the sufficiency of financial resources and model validation. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[462] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(4) would impose an aggregate annual burden on respondent clearing agencies of 420 hours.[463]

b. Proposed Rule 17Ad-22(e)(5)

Respondent clearing agencies that would be subject to proposed Rule 17Ad-22(e)(5) may already have some written policies and procedures designed to address the collateral risks borne by these entities.[464] As a result, the Commission preliminarily believes that a respondent clearing agency may need to review and update existing policies and procedures as necessary and may need to adopt new policies and procedures with respect to an annual review of the sufficiency of collateral haircuts and concentration limits. Accordingly, based on the similar policies and procedures requirements in and the Commission's previous corresponding burden estimates for existing Rule 17Ad-22(d)(3),[465] the Commission preliminarily believes that respondent clearing agencies would incur an aggregate one-time burden of approximately 294

462 See Clearing Agency Standards Release, supra note 5, at 66260–63.

463 This figure was calculated as follows: ((Compliance Attorney for 24 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 3 hours) + (Risk Management Specialist for 30 hours)) = 60 hours x 7 respondent clearing agencies = 420 hours.

464 See 17 CFR 240.17Ad-22(d)(3); proposed Rule 17Ad-22(e)(5), infra Part VII; see also supra Part II.B.4.d (discussing the requirements under the proposed rule).

465 See Clearing Agency Standards Release, supra note 5, at 66260.

hours to review and update existing policies and procedures and to create new policies and procedures, as necessary.[466]

Proposed Rule 17Ad-22(e)(5) would also impose ongoing burdens on a respondent clearing agency. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule and would also result in an annual review of collateral haircuts and concentration limits. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[467] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(5) would impose an aggregate annual burden on respondent clearing agencies of 252 hours.[468] The Commission notes that the estimated ongoing burden for Proposed Rule 17Ad-22(e)(5) is similar to the initial one-time burden because the proposed rule includes a specific requirement that policies and procedures for collateral include a not-less-than-annual review of the sufficiency of a covered clearing agency's collateral haircuts and concentration limits.

c. Proposed Rule 17Ad-22(e)(6)

The Commission preliminarily believes that the estimated PRA burdens for proposed Rule 17Ad-22(e)(6) would be more significant and may require a respondent clearing agency to

466 This figure was calculated as follows: ((Assistant General Counsel for 16 hours) + (Compliance Attorney for 12 hours) + (Senior Risk Management Specialist for 7 hours) + (Computer Operations Manager for 7 hours)) = 42 hours x 7 respondent clearing agencies = 294 hours.

467 See Clearing Agency Standards Release, supra note 5, at 66260–63.

468 This figure was calculated as follows: ((Compliance Attorney for 6 hours) + (Risk Management Specialist for 30 hours)) = 36 hours x 7 respondent clearing agencies = 252 hours.

make substantial changes to its policies and procedures.[469] In addition, proposed Rule 17Ad-22(e)(6) would require one-time systems adjustments related to the capability to perform daily backtesting and monthly (or more frequent than monthly) conforming sensitivity analyses. As a result, the Commission preliminarily estimates that respondent clearing agencies would incur an aggregate one-time burden of 1,080 hours to review and update existing policies and procedures.[470]

Proposed Rule 17Ad-22(e)(6) would also impose ongoing burdens on a respondent clearing agency. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule and activities associated with the daily backtesting and monthly (or more frequent) sensitivity analysis requirements and annual model validation. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[471] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(6) would impose an aggregate annual burden on respondent clearing agencies of 360 hours.[472]

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469 See proposed Rule 17Ad-22(e)(6), infra Part VII; see also supra Part II.B.4.e (discussing the requirements under the proposed rule, including those that do not appear in existing Rule 17Ad-22).

470 This figure was calculated as follows: ((Assistant General Counsel for 50 hours) + (Compliance Attorney for 40 hours) + (Senior Risk Management Specialist for 25 hours) + (Computer Operations Manager for 40 hours) + (Chief Compliance Officer for 15 hours) + (Senior Programmer for 10 hours)) = 180 hours x 6 respondent clearing agencies = 1,080 hours.

471 See Clearing Agency Standards Release, supra note 5, at 66260–63.

472 This figure was calculated as follows: ((Compliance Attorney for 24 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 3 hours) + (Risk Management Specialist for 30 hours)) = 60 hours x 6 respondent clearing agencies = 360 hours.

d. **Proposed Rule 17Ad-22(e)(7)**

The Commission preliminarily believes that the estimated PRA burdens for proposed Rule 17Ad-22(e)(7) would be more significant and may require a respondent clearing agency to make substantial changes to its policies and procedures.[473] In addition, proposed Rule 17Ad-22(e)(7) would require one-time systems adjustments related to the capability to perform an annual conforming model validation, the testing of sufficiency of liquid resources and the testing of access to liquidity providers. As a result, the Commission preliminarily estimates that respondent clearing agencies would incur an aggregate one-time burden of 2,310 hours to review and update existing policies and procedures.[474]

Proposed Rule 17Ad-22(e)(7) would also impose ongoing burdens on a respondent clearing agency. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule as well as activities related to the testing of sufficiency of liquidity resources and the testing of access to liquidity providers. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[475] the Commission

473 See proposed Rule 17Ad-22(e)(7), infra Part VII; see also supra Part II.B.4.f (discussing the requirements under the proposed rule).

474 This figure was calculated as follows: ((Assistant General Counsel for 95 hours) + (Compliance Attorney for 85 hours) + (Senior Risk Management Specialist for 45 hours) + (Computer Operations Manager for 60 hours) + (Chief Compliance Officer for 30 hours) + (Senior Programmer for 15 hours)) = 330 hours x 7 respondent clearing agencies = 2,310 hours.

475 See Clearing Agency Standards Release, supra note 5, at 66260–63.

preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(7) would impose an aggregate annual burden on respondent clearing agencies of 896 hours.[476]

3. Proposed Rules 17Ad-22(e)(8) through (10): Settlement

a. Proposed Rule 17Ad-22(e)(8)

Proposed Rule 17Ad-22(e)(8) contains substantially similar provisions to Rule 17Ad-22(d)(12).[477] As a result, a respondent clearing agency would already have written rules, policies, and procedures substantially similar to the requirements that would be imposed under the proposed rule. In this regard, the Commission preliminarily believes that respondent clearing agencies would incur the incremental burdens of reviewing and updating existing policies and procedures as necessary. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(12),[478] the Commission preliminarily believes that respondent clearing agencies would incur an aggregate one-time burden of approximately 84 hours to review and update existing policies and procedures.[479]

Proposed Rule 17Ad-22(e)(8) would also impose ongoing burdens on a respondent clearing agency. The proposed requirements would require ongoing monitoring and compliance

476 This figure was calculated as follows: ((Compliance Attorney for 48 hours) + (Administrative Assistant for 5 hours) + (Senior Business Analyst for 5 hours) + (Risk Management Specialist for 60 hours) + (Senior Risk Management Specialist for 10 hours)) = 128 hours x 7 respondent clearing agencies = 896 hours.

477 See 17 CFR 240.17Ad-22(d)(12); proposed Rule 17Ad-22(e)(8), infra Part VII; see also supra Part II.B.5 (discussing the requirements under the proposed rule).

478 See Clearing Agency Standards Release, supra note 5, at 66260.

479 This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Senior Business Analyst for 2 hours) + (Computer Operations Manager for 2 hours)) = 12 hours x 7 respondent clearing agencies = 84 hours.

activities with respect to the written policies and procedures created in response to the proposed rules. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[480] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(8) would impose an aggregate annual burden on respondent clearing agencies of approximately 35 hours.[481]

b. Proposed Rule 17Ad-22(e)(9)

Proposed Rule 17Ad-22(e)(9) contains substantially similar provisions to Rule 17Ad-22(d)(5).[482] As a result, a respondent clearing agency would already have written rules, policies, and procedures substantially similar to the requirements that would be imposed under the proposed rule. In this regard, the Commission preliminarily believes that respondent clearing agencies would incur the incremental burdens of reviewing and updating existing policies and procedures as necessary. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(5),[483] the Commission preliminarily believes that respondent clearing agencies would incur an aggregate one-time burden of approximately 84 hours to review and update existing policies and procedures.[484]

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480 See Clearing Agency Standards Release, supra note 5, at 66260–63.

481 This figure was calculated as follows: (Compliance Attorney for 5 hours) x 7 respondent clearing agencies = 35 hours.

482 See 17 CFR 240.17Ad-22(d)(5); proposed Rule 17Ad-22(e)(9), infra Part VII; see also supra Part II.B.6 (discussing the requirements under the proposed rule).

483 See Clearing Agency Standards Release, supra note 5, at 66260.

484 This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Senior Business Analyst for 2 hours) + (Computer Operations Manager for 2 hours)) = 12 hours x 7 respondent clearing agencies = 84 hours.

Proposed Rule 17Ad-22(e)(9) would also impose ongoing burdens on a respondent clearing agency. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[485] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(9) would impose an aggregate annual burden on respondent clearing agencies of approximately 35 hours.[486]

c. Proposed Rule 17Ad-22(e)(10)

Proposed Rule 17Ad-22(e)(10) contains substantially similar provisions to Rule 17Ad-22(d)(15).[487] As a result, a respondent clearing agency would already have written rules, policies, and procedures substantially similar to the requirements that would be imposed under the proposed rule. In this regard, the Commission preliminarily believes that a respondent clearing agency would incur the incremental burdens of reviewing and updating existing policies and procedures as necessary. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(15),[488] the Commission preliminarily believes that respondent clearing

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485 See Clearing Agency Standards Release, supra note 5, at 66260–63.

486 This figure was calculated as follows: (Compliance Attorney for 5 hours) x 7 respondent clearing agencies = 35 hours.

487 See 17 CFR 240.17Ad-22(d)(15); proposed Rule 17Ad-22(e)(10), infra Part VII; see also supra Part II.B.7 (discussing the requirements under the proposed rule).

488 See Clearing Agency Standards Release, supra note 5, at 66260.

agencies would incur an aggregate one-time burden of approximately 84 hours to review and update existing policies and procedures.[489]

Proposed Rule 17Ad-22(e)(10) would also impose ongoing burdens on a respondent clearing agency. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[490] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(10) would impose an aggregate annual burden on respondent clearing agencies of approximately 35 hours.[491]

4. Proposed Rules 17Ad-22(e)(11) through (12): CSDs and Exchange-of-Value Settlement Systems

a. Proposed Rule 17Ad-22(e)(11)

Proposed Rule 17Ad-22(e)(11) contains similar provisions to Rule 17Ad-22(d)(10).[492] As a result, a respondent clearing agency providing CSD services would already have written rules, policies, and procedures similar to the requirements that would be imposed under the proposed rule but also imposes additional requirements that do not appear in existing Rule 17Ad-22,[493] and

489 This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Senior Business Analyst for 2 hours) + (Computer Operations Manager for 2 hours)) = 12 hours x 7 respondent clearing agencies = 84 hours.

490 See Clearing Agency Standards Release, supra note 5, at 66260–63.

491 This figure was calculated as follows: (Compliance Attorney for 5 hours) x 7 respondent clearing agencies = 35 hours.

492 See 17 CFR 240.17Ad-22(d)(10); proposed Rule 17Ad-22(e)(11), infra Part VII.

493 See supra Part II.B.8 (discussing the requirements under the proposed rule and their relationship to existing requirements under Rule 17Ad-22(d)(10)).

accordingly a covered clearing agency providing CSD services may need to update or amend existing policies and procedures, as necessary, to satisfy the proposed requirements and may need to create new policies and procedures. Based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(10),[494] the Commission preliminarily believes that the respondent clearing agency would incur a one-time burden of approximately 55 hours to review and update existing policies and procedures and to create new policies and procedures, as necessary.[495]

Proposed Rule 17Ad-22(e)(11) would also impose ongoing burdens on the respondent clearing agency providing CSD services. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[496] the Commission preliminarily estimates that the ongoing activities required by proposed Rules 17Ad-22(e)(11) would impose a total annual burden on the respondent clearing agency of approximately 8 hours.[497]

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494 See Clearing Agency Standards Release, supra note 5, at 66260.

495 This figure was calculated as follows: ((Assistant General Counsel for 20 hours) + (Compliance Attorney for 10 hours) + (Intermediate Accountant for 15 hours) + (Senior Business Analyst for 5 hours) + (Computer Operations Manager for 5 hours)) = 55 hours x 1 respondent clearing agency = 55 hours.

496 See Clearing Agency Standards Release, supra note 5, at 66260–63.

497 This figure was calculated as follows: (Compliance Attorney for 8 hours) x 1 respondent clearing agency = 8 hours.

b. Proposed Rule 17Ad-22(e)(12)

Proposed Rule 17Ad-22(e)(12) contains substantially similar provisions to Rule 17Ad-22(d)(13).[498] As a result, a respondent clearing agency would already have written rules, policies, and procedures substantially similar to the requirements that would be imposed under the proposed rule. In this regard, the Commission preliminarily believes that a respondent clearing agency would incur the incremental burdens of reviewing and updating existing policies and procedures as necessary. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(13),[499] the Commission preliminarily believes that respondent clearing agencies would incur an aggregate one-time burden of approximately 84 hours to review and update existing policies and procedures.[500]

Proposed Rule 17Ad-22(e)(12) would also impose ongoing burdens on a covered clearing agency. The proposed requirement would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[501] the Commission preliminarily estimates that the

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498 See 17 CFR 240.17Ad-22(d)(13); proposed Rule 17Ad-22(e)(12), infra Part VII; see also supra Part II.B.9 (discussing the requirements under the proposed rule).

499 See Clearing Agency Standards Release, supra note 5, at 66260.

500 This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Senior Business Analyst for 2 hours) + (Computer Operations Manager for 2 hours)) = 12 hours x 7 respondent clearing agencies = 84 hours.

501 See Clearing Agency Standards Release, supra note 5, at 66260–63.

ongoing activities required by proposed Rule 17Ad-22(e)(12) would impose an aggregate annual burden on respondent clearing agencies of approximately 35 hours.[502]

5. Proposed Rules 17Ad-22(e)(13) through (14): Default Management

a. Proposed Rule 17Ad-22(e)(13)

Proposed Rule 17Ad-22(e)(13) would require a respondent clearing agency to have written policies and procedures reasonably designed to address participant default and ensure that the clearing agency can contain losses and liquidity demands and continue to meet its obligations. Proposed Rule 17Ad-22(e)(13) contains similar provisions to Rule 17Ad-22(d)(11) but would also impose additional requirements that do not appear in existing Rule 17Ad-22.[503] As a result, the Commission preliminarily believes that a respondent clearing agency would incur burdens of reviewing and updating existing policies and procedures in order to comply with the provisions of proposed Rule 17Ad-22(e)(13) and, in some cases, may need to create new policies and procedures. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(11),[504] the Commission preliminarily believes that respondent clearing agencies would

502 This figure was calculated as follows: (Compliance Attorney for 5 hours) x 7 respondent clearing agencies = 35 hours.

503 See 17 CFR 240.17Ad-22(d)(11); proposed Rule 17Ad-22(e)(13), infra Part VII; see also supra Part II.B.10 (discussing the requirements under the proposed rule and their relationship to existing Rule 17Ad-22(d)(11).

504 See Clearing Agency Standards Release, supra note 5, at 66260.

incur an aggregate one-time burden of approximately 420 hours to review and update existing policies and procedures and to create new policies and procedures, as necessary.[505]

Proposed Rule 17Ad-22(e)(13) would also impose ongoing burdens on a respondent clearing agency. Specifically, the proposed rule would require annual review and testing of a clearing agency's default policies and procedures. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[506] the Commission preliminarily believes that the ongoing activities required by proposed Rule 17Ad-22(e)(13) would impose an aggregate annual burden on respondent clearing agencies of approximately 63 hours.[507]

b. Proposed Rule 17Ad-22(e)(14)

Registered clearing agencies that provide CCP services for security-based swaps generally have written policies and procedures regarding the segregation and portability of customer positions and collateral as a result of applicable regulations but not existing Rule 17Ad-22.[508] As a result, respondent clearing agencies providing CCP services for security-based swaps would incur burdens of reviewing and updating existing policies and procedures as necessary in

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505 This figure was calculated as follows: ((Assistant General Counsel for 20 hours) + (Compliance Attorney for 16 hours) + (Senior Business Analyst for 12 hours) + (Computer Operations Manager for 12 hours)) = 60 hours x 7 respondent clearing agencies = 420 hours.

506 See Clearing Agency Standards Release, supra note 5, at 66260–63.

507 This figure was calculated as follows: (Compliance Attorney for 9 hours) x 7 respondent clearing agencies = 63 hours.

508 See, e.g., 77 FR 6336 (Feb. 7, 2012) (CFTC adopting rules imposing LSOC on DCOs for cleared swaps); see also supra Part II.B.11, in particular note 297 and accompanying text. Because the affected clearing agencies are subject to the CFTC's segregation and portability requirements with respect to cleared swaps under LSOC, the Commission preliminarily believes the burden imposed by proposed Rule 17Ad-22(e)(14) would be limited.

order to comply with the proposed rule. The Commission preliminarily estimates that Rule 17Ad-22(e)(14) would impose on respondent clearing agencies an aggregate one-time burden of 72 hours to review and update existing policies and procedures.[509]

Proposed Rule 17Ad-22(e)(14) would also impose ongoing burdens on a respondent clearing agency that provides CCP services for security-based swaps. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[510] the Commission preliminarily believes that the ongoing activities required by proposed Rule 17Ad-22(e)(14) would impose an aggregate annual burden on respondent clearing agencies of approximately 12 hours.[511]

6. Proposed Rules 17Ad-22(e)(15) through (17): General Business and Operational Risk Management

a. Proposed Rule 17Ad-22(e)(15)

Respondent clearing agencies would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify and manage general business risks borne by the clearing agency. Policies and procedures governing the identification and mitigation of general business risk are not currently required under existing Rule 17Ad-22 and, as a result, the Commission preliminarily believes that the estimated PRA burdens for proposed Rule 17Ad-22(e)(15) would be more significant and may require a respondent clearing

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509 This figure was calculated as follows: ((Assistant General Counsel for 12 hours) + (Compliance Attorney for 10 hours) + (Computer Operations Manager for 7 hours) + (Senior Business Analyst for 7 hours)) = 36 hours x 2 respondent clearing agency that provide, or would potentially provide, CCP services with respect to security-based swaps = 72 hours.

510 See Clearing Agency Standards Release, supra note 5, at 66260–63.

511 This figure was calculated as follows: (Compliance Attorney for 6 hours) x 2 respondent clearing agencies = 12 hours

agency to make substantial changes to its policies and procedures.[512] The Commission preliminarily estimates that proposed Rule 17Ad-22(e)(15) would impose an aggregate one-time burden on respondent covered clearing agencies of 1,470 hours to review and update existing policies and procedures and to create new policies and procedures, as necessary.[513]

Proposed Rule 17Ad-22(e)(15) would also imposed ongoing burdens on a respondent clearing agency. Proposed Rule 17Ad-22(e)(15) would require a respondent clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a viable plan, approved by its board of directors and updated at least annually, for raising additional equity in the event that the covered clearing agency's liquid net assets fall below the level required by the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[514] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(15) would impose an aggregate annual burden on respondent clearing agencies of 336 hours.[515]

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512 See proposed Rule 17Ad-22(e)(15), infra Part VII; see also supra Part II.B.12 (discussing the requirements under the proposed rule).

513 This figure was calculated as follows: ((Assistant General Counsel for 40 hours) + (Compliance Attorney for 30 hours) + (Computer Operations Manager for 10 hours) + (Senior Business Analyst for 10 hours) + (Financial Analyst for 70 hours) + (Chief Financial Officer for 50 hours)) = 210 hours x 7 respondent clearing agencies = 1,470 hours.

514 See Clearing Agency Standards Release, supra note 5, at 66260–63.

515 This figure was calculated as follows: ((Compliance Attorney for 42 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 3 hours)) = 48 hours x 7 respondents clearing agencies = 336 hours.

b. Proposed Rule 17Ad-22(e)(16)

A registered clearing agency is currently required to have written policies and procedures reasonably designed to address, in large part, the safeguarding of assets of its assets and those of its participants under Rule 17Ad-22(d)(3).[516] Proposed Rule 17Ad-22(e)(16) contains substantially similar provisions. As a result, the Commission preliminarily believes that a respondent clearing agency would be required to conduct a review of current policies and procedures and update these existing policies and procedures where appropriate in order to ensure compliance with the proposed rule and that the PRA burden imposed by the proposed rule would be limited. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(3),[517] the Commission preliminarily estimates that all respondent clearing agencies would incur an aggregate one-time burden of approximately 140 hours to review and update existing policies and procedures.[518]

Proposed Rule 17Ad-22(e)(16) would also impose ongoing burdens on a respondent clearing agency. It would require ongoing monitoring and compliance activities with respect to the policies and procedures implemented in response to the requirements of the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens

516 See 17 CFR 240.17Ad-22(d)(3); proposed Rule 17Ad-22(e)(16), infra Part VII; see also supra Part II.B.13 (discussing the requirements under the proposed rule).

517 See Clearing Agency Standards Release, supra note 5, at 66260.

518 This figure was calculated as follows: ((Assistant General Counsel for 4 hours) + (Compliance Attorney for 8 hours) + (Senior Business Analyst for 4 hours) + (Computer Operations Manager for 4 hours)) = 20 hours x 7 respondent clearing agencies = 140 hours.

with respect to existing Rule 17Ad-22,[519] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(16) would impose an aggregate annual burden on respondent clearing agencies of 42 hours.[520]

c. Proposed Rule 17Ad-22(e)(17)

Proposed Rule 17Ad-22(e)(17) contains similar requirements to those under Rule 17Ad-22(d)(4) but would also impose additional requirements that do not appear in existing Rule 17Ad-22.[521] As a result, a respondent clearing agency is currently required to have some written rules, policies and procedures containing provisions similar to the requirements that would be imposed under the proposed rule, but it would also need to review and update existing policies and procedures, where necessary, and may need to create policies and procedures to address the additional requirements. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(4),[522] the Commission preliminarily estimates that respondent clearing agencies would incur an aggregate one-time burden of 196 hours to review and update existing policies and procedures and to create new policies and procedures, as necessary.[523]

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519 See Clearing Agency Standards Release, supra note 5, at 66260–63.

520 This figure was calculated as follows: (Compliance Attorney for 6 hours) x 7 respondent clearing agencies = 42 hours.

521 See 17 CFR 240.17Ad-22(d)(4); proposed Rule 17Ad-22(e)(17), infra Part VII; see also supra Part II.B.14 (discussing the requirements under the proposed rule).

522 See Clearing Agency Standards Release, supra note 5, at 66260.

523 This figure was calculated as follows: ((Assistant General Counsel for 4 hours) + (Compliance Attorney for 8 hours) + (Computer Operations Manager for 6 hours) + (Senior Business Analyst for 4 hours) + (Chief Compliance Officer for 4 hours) + (Senior Programmer for 2 hours)) = 28 hours x 7 respondent clearing agency = 196 hours.

Proposed Rule 17Ad-22(e)(17) would also impose ongoing burdens on a respondent clearing agency. Specifically, the proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[524] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(17) would impose an aggregate annual burden on respondent clearing agencies of 112 hours.[525]

7. Proposed Rules 17Ad-22(e)(18) through (20): Access

a. Proposed Rule 17Ad-22(e)(18)

Proposed Rule 17Ad-22(e)(18) contains similar requirements to those in existing Rules 17Ad-22(b)(5) through (7) and (d)(2).[526] As a result, a respondent clearing agency is currently required to have written rules, policies, and procedures containing provisions similar to the requirements that would be imposed under the proposed rule. Thus, for certain portions of proposed Rule 17Ad-22(e)(18), the Commission preliminarily believes that a respondent clearing agency would need to review and update existing policies and procedures where necessary. Because proposed Rule 17Ad-22(e)(18) also imposes additional requirements that do not appear in existing Rule 17Ad-22, however,[527] a respondent clearing agency may be required to create policies and procedures to address these additional requirements. Accordingly, based on the

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524 See Clearing Agency Standards Release, supra note 5, at 66260–63.

525 This figure was calculated as follows: (Compliance Attorney for 6 hours) x 7 respondent clearing agencies = 42 hours.

526 See 17 CFR 240.17Ad-22(b)(5) through (7) and (d)(2).

527 See proposed Rule 17Ad-22(e)(18), infra Part VII; see also supra Part II.B.15 (discussing the requirements under the proposed rule).

similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rules 17Ad-22(b)(5) through (7) and (d)(2),[528] the Commission preliminarily estimates that respondent clearing agencies would incur an aggregate one-time burden of 308 hours to review and update existing policies and procedures and to create new policies and procedures, as necessary.[529]

Proposed Rule 17Ad-22(e)(18) would also impose ongoing burdens on a respondent clearing agency. Specifically, the proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[530] the Commission preliminarily estimates that the ongoing activities required by the proposed rule would impose an aggregate annual burden on respondent clearing agencies of 49 hours.[531]

b. Proposed Rule 17Ad-22(e)(19)

Respondent clearing agencies would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to address material risks associated from tiered participation arrangements as required by proposed Rule 17Ad-22(e)(19). Tiered participation arrangements are not addressed in existing Rule 17Ad-22. To the extent that a

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528 See Clearing Agency Standards Release, supra note 5, at 66260.

529 This figure was calculated as follows: ((Assistant General Counsel for 10 hours) + (Compliance Attorney for 7 hours) + Computer Operations Manager for 15 hours) + (Senior Business Analyst for 5 hours) + (Chief Compliance Officer for 5 hours) + (Senior Programmer for 2 hours)) = 44 hours x 7 respondent clearing agencies = 308 hours.

530 See Clearing Agency Standards Release, supra note 5, at 66260.

531 This figure was calculated as follows: (Compliance Attorney for 7 hours) x 7 respondent clearing agencies = 49 hours.

respondent clearing agency has not addressed tiered participation arrangements in its policies and procedures, the Commission preliminarily believes that the respondent clearing agency would need to create policies and procedures to address these proposed requirements. In this regard, the PRA burden for proposed Rule 17Ad-22(e)(19) would impose one-time initial burdens to create policies and procedures. The Commission preliminarily estimates that proposed Rule 17Ad-22(e)(19) would impose an aggregate one-time burden on respondent clearing agencies of 308 hours to create said policies and procedures.[532]

Proposed Rule 17Ad-22(e)(19) would also impose ongoing burdens on a respondent clearing agency. Specifically, the proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[533] the Commission preliminarily estimates that the ongoing activities required by the proposed rule would impose an annual aggregate burden on respondent clearing agencies of 49 hours.[534]

c. Proposed Rule 17Ad-22(e)(20)

Registered clearing agencies are currently required to have written policies and procedures reasonably designed to manage risks related to links between the clearing agency and others under Rule 17Ad-22(d)(7). Proposed Rule 17Ad-22(e)(20) contains similar requirements,

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532 This figure was calculated as follows: ((Assistant General Counsel for 10 hours) + (Compliance Attorney for 7 hours) + (Computer Operations Manager for 15 hours) + (Senior Business Analyst for 5 hours) + (Chief Compliance Officer for 5 hours) + (Senior Programmer for 2 hours)) = 44 hours x 7 respondent clearing agencies = 308 hours.

533 See Clearing Agency Standards Release, supra note 5, at 66260.

534 This figure was calculated as follows: (Compliance Attorney for 7 hours) x 7 respondent clearing agencies = 49 hours.

but also imposes additional requirements.[535] As a result, a respondent clearing agency may need to review and update existing policies and procedures or establish new policies and procedures, as necessary, to satisfy the proposed requirement. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(7),[536] the Commission preliminarily believes that respondent clearing agencies would incur an aggregate one-time burden of approximately 308 hours to review and update existing policies and procedures.[537]

Proposed Rule 17Ad-22(e)(20) would also impose ongoing burdens on a respondent clearing agency. Specifically, the proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[538] the Commission preliminarily estimates that the ongoing activities required by the proposed rule would impose an aggregate annual burden on respondent clearing agencies of 49 hours.[539]

535 See17 CFR 240.17Ad-22(d)(7); proposed Rule 17Ad-22(e)(20), infra Part VII; see also supra Part II.B.17 (discussing the requirements under the proposed rule).

536 See Clearing Agency Standards Release, supra note 5, at 66260.

537 This figure was calculated as follows: ((Assistant General Counsel for 10 hours) + (Compliance Attorney for 7 hours) + (Senior Business Analyst for 5 hours) + (Computer Operations Manager for 15 hours) + (Chief Compliance Officer for 5 hours) + (Senior Programmer for 2 hours) = 44 hours x 7 respondent clearing agencies = 308 hours.

538 See Clearing Agency Standards Release, supra note 5, at 66260.

539 This figure was calculated as follows: (Compliance Attorney for 7 hours) x 7 respondent clearing agencies = 49 hours.

8. Proposed Rules 17Ad-22(e)(21) through (22): Efficiency

a. Proposed Rule 17Ad-22(e)(21)

Registered clearing agencies are currently required to have written policies and procedures requiring the clearing agency to be cost effective with respect to meeting the requirements of its participants and the markets it serves under Rule 17Ad-22(d)(6), and proposed Rule 17Ad-22(e)(21) contains similar requirements but also imposes new requirements.[540] As a result, a respondent clearing agency would likely incur the burdens of reviewing and updating existing policies and procedures and may need to create new policies and procedures to satisfy the proposed rule, as necessary. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(6),[541] the Commission preliminarily estimates that that respondent clearing agencies would incur an aggregate one-time burden of approximately 224 hours to review and update existing policies and procedures.[542]

Proposed Rule 17Ad-22(e)(21) would also impose ongoing burdens on a respondent clearing agency. The proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures required under the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[543] the Commission preliminarily estimates that the ongoing

540 See 17 CFR 240.17Ad-22(d)(6).

541 See Clearing Agency Standards Release, supra note 5, at 66260.

542 This figure was calculated as follows: ((Assistant General Counsel for 10 hours) + (Compliance Attorney for 7 hours) + (Senior Business Analyst for 5 hours) + (Computer Operations Manager for 10 hours)) = 32 hours x 7 respondent clearing agencies = 224 hours.

543 See Clearing Agency Standards Release, supra note 5, at 66260.

activities required by proposed Rule 17Ad-22(e)(21) would impose an aggregate annual burden on respondent clearing agencies of 77 hours.[544]

b. Proposed Rule 17Ad-22(e)(22)

Respondent clearing agencies would be required to establish, implement, maintain and enforce written policies and procedures reasonably designed to implement the requirements of proposed Rule 17Ad-22(e)(22) with respect to the use of relevant internationally accepted communication procedures and standards. Although registered clearing agencies are not subject to an existing similar requirement under Rule 17Ad-22, the Commission understands that covered clearing agencies currently use the relevant internationally accepted communication procedures and standards and expects a covered clearing agency would need to make only limited changes to satisfy the requirements under the proposed rule.[545] Accordingly, the Commission preliminarily estimates that proposed Rule 17Ad-22(e)(22) would impose an aggregate one-time burden on respondent clearing agencies of 168 hours to review and update existing policies and procedures.[546]

Proposed Rule 17Ad-22(e)(22) would also impose ongoing burdens on a respondent clearing agency. Specifically, the proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to

544 This figure was calculated as follows: ((Compliance Attorney for 5 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 3 hours) = 11 hours x 7 respondent clearing agencies = 77 hours.

545 See supra note 441.

546 This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Computer Operations Manager for 7 hours) + (Senior Business Analyst for 2 hours) + (Chief Compliance Officer for 5 hours) + (Senior Programmer for 2 hours)) = 24 hours x 7 respondent clearing agencies = 168 hours.

the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[547] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(22) would impose an aggregate annual burden on respondent clearing agencies of 35 hours.[548]

9. Proposed Rule 17Ad-22(e)(23): Disclosure

Proposed Rule 17Ad-22(e)(23) contains similar requirements to Rule 17Ad-22(d)(9) but also imposes substantial new requirements.[549] As a result, although a respondent clearing agency is already required to have written rules, policies and procedures containing provisions similar to some of the requirements in the proposed rule, for some provisions of proposed Rule 17Ad-22(e)(23), a respondent clearing agency would be required to establish policies and procedures to address the additional requirements. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(9),[550] the Commission preliminarily estimates that respondent clearing agencies would incur an aggregate one-time burden of 966 hours to review and update existing policies and procedures and to create policies and procedures, as necessary.[551]

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547 See Clearing Agency Standards Release, supra note 5, at 66260.

548 This figure was calculated as follows: (Compliance Attorney for 5 hours) x 7 respondent clearing agencies = 35 hours.

549 See 17 CFR 240.17Ad-22(d)(9); proposed Rule 17Ad-22(e)(23), infra Part VII; see also supra Part II.B.20 (discussing the requirements under the proposed rule).

550 See Clearing Agency Standards Release, supra note 5, at 66260.

551 This figure was calculated as follows: ((Assistant General Counsel for 38 hours) + (Compliance Attorney for 24 hours) + (Computer Operations Manager for 32 hours) + (Senior Business Analyst for 18 hours) + (Chief Compliance Officer for 18 hours) + (Senior Programmer for 8 hours)) = 138 hours x 7 respondent clearing agencies = 966 hours.

Proposed Rule 17Ad-22(e)(23) would also impose ongoing burdens on a respondent clearing agency. Specifically, the proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[552] the Commission preliminarily estimates that the ongoing activities required by proposed Rule 17Ad-22(e)(23) would impose an aggregate annual burden on respondent clearing agencies of 238 hours.[553]

10. Total Burden for Proposed Rule 17Ad-22(e)

The aggregate initial burden for respondent clearing agencies under proposed Rule 17Ad-22(e) would be 10,664 hours. The aggregate ongoing burden for respondent clearing agencies under proposed Rule 17Ad-22(e) would be 3,460 hours.

E. Total Annual Reporting and Recordkeeping Burden for Proposed Rule 17Ab2-2

Proposed Rule 17Ab2-2 would govern Commission determinations as to whether a registered clearing agency is a covered clearing agency and whether a covered clearing agency is either involved in activities with a more complex risk profile or systemically important in multiple jurisdictions.[554] Because such determinations may be made upon request of a clearing agency or its members, the respondents would have the burdens of preparing such requests for submission to the Commission. The Commission preliminarily notes that, to the extent such determinations are carried out by the Commission on its own initiative pursuant to proposed Rule

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552 See Clearing Agency Standards Release, supra note 5, at 66260.

553 This figure was calculated as follows: (Compliance Attorney for 34 hours) x 7 respondent clearing agencies = 238 hours.

554 See infra Part II.C (further discussing the purpose, scope, and application of proposed Rule 17Ab2-2) and Part VII (proposed text of Rule 17Ab2-2).

17Ab2-2, the PRA burdens on the respondents would be limited. Accordingly, based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to existing Rule 17Ad-22,[555] the Commission preliminarily believes that respondent clearing agencies would incur an aggregate one-time burden of approximately 24 hours to draft and review a determination request to the Commission.[556]

F. Collection of Information is Mandatory

The collection of information relating to proposed Rules 17Ad-22(e)(1) through (3), 17Ad-22(e)(4)(ii) through (v), 17Ad-22(e)(7)(i) through (ix), and 17Ad-22(e)(8) through (23) would be mandatory for all respondent clearing agencies. The collection of information requirement relating to proposed Rule 17Ad-22(e)(4)(i) and 17Ad-22(e)(7)(x) would be mandatory for a respondent clearing agency that provides CCP services and that is designated by the Commission either as systemically important in multiple jurisdictions or as a complex risk profile clearing agency. The collection of information requirement relating to proposed Rule 17Ad-22(e)(6) would be mandatory for a respondent clearing agency that provides CCP services.

The collection of information requirement relating to proposed Rule 17Ab2-2 is voluntary.

G. Confidentiality

The Commission preliminarily expects that the written policies and procedures generated pursuant to proposed Rule 17Ad-22(e) would be communicated to the members, subscribers, and employees (as applicable) of all entities covered by the proposed rule and the public (as

555 See Clearing Agency Standards Release, supra note 5, at 66260.

556 This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Staff Attorney for 4 hours) + (Outside Counsel for 6 hours)) = 12 hours x 2 respondent clearing agencies = 24 hours.

applicable). To the extent that this information is made available to the Commission, it would not be kept confidential. Such policies and procedures would be required to be preserved in accordance with, and for periods specified in, Exchange Act Rules 17a-1[557] and 17a-4(e)(7).[558] To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential subject to the provisions of applicable law.[559]

To the extent that the Commission receives confidential information pursuant to the collection of information under proposed Rule 17Ab2-2, the Commission preliminarily expects such information would be kept confidential subject to the provisions of applicable law.[560]

H. Request for Comments

The Commission invites comments on all of the above estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission requests comment in order to (a) evaluate whether the collection of information is necessary for the proper performance of our functions, including whether the information will have practical utility; (b) evaluate the accuracy of our estimates of the burden of the collection of information; (c) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; (d) evaluate whether there are ways to

557 17 CFR 240.17a-1.

558 17 CFR 240.17a-4(e)(7).

559 See, e.g., 5 U.S.C. 552. Exemption 4 of the Freedom of Information Act provides an exemption for trade secrets and commercial or financial information obtained from a person and privileged or confidential. See 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions. See 5 U.S.C. 552(b)(8).

560 See id.

minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and (e) determine whether there are cost savings associated with the collection of information that have not been identified in this proposal.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Kevin M. O'Neill, Deputy Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090, with reference to File No. S7-03-14. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File No. S7-03-14, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, N.E., Washington, DC 20549-0213. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it by [insert date that is 30 days from the date of publication in the Federal Register].

IV. Economic Analysis

A. Introduction

The purpose of the proposed amendments to Rule 17Ad-22 and of proposed Rule 17Ab2-2 is to establish requirements for the operation and governance of registered clearing agencies that meet the definition of a "covered clearing agency." Registered clearing agencies have become an essential part of the infrastructure of the U.S. securities markets. Many securities transactions are centrally cleared and settled, and central clearing and settlement is becoming more prevalent in the security-based swap markets. For example, DTCC reported processing

$1.6 quadrillion in transactions in 2012.[561] For the same period, Intercontinental Exchange, Inc. reported $10.2 trillion in gross notional CDS cleared and settled.[562] While clearing agencies generally benefit the markets they serve, such entities can pose substantial risk to the financial system as a whole, due in part to the fact that clearing agencies concentrate risk. Disruption to a clearing agency's operations, or failure on the part of a clearing agency to meet its obligations, could serve as a potential source of contagion, resulting in significant costs not only to the clearing agency and its members but also the broader economy and market participants.[563] As a

561 See DTCC, 2012 Annual Report, available at http://www.dtcc.com/about/annual-report.aspx.

562 See Intercontinental Exchange, Inc., 2012 Annual Report, at 66, available at https://materials.proxyvote.com/Approved/45865V/20130319/AR_159922/. Intercontinental Exchange, Inc. is the parent company of ICE and ICEEU.

ICE began clearing corporate single-name CDS in December 2009, and as of February 1, 2013, had cleared $1.9 trillion gross notional of single-name CDS on 153 North American corporate reference entities. See Exchange Act Release No. 34-61662 (Mar. 5, 2010), 75 FR 11589, 11591 (Mar. 11, 2010) (discussing ICE's credit default swap clearing activities as of March 2010); ICE, Volume of ICE CDS Clearing, available at https://www.theice.com/clear_credit.jhtml.

ICEEU began clearing CDS on single-name corporate reference entities in December 2009, and, as of February 1, 2013, had cleared €1.6 trillion in gross notional of single-name CDS on 121 European corporate reference entities. See Exchange Act Release No. 61973 (Apr. 23, 2010), 75 FR 22656, 22657 (Apr. 29, 2010) (discussing ICEEU's credit default swap clearing activity as of April 2010); ICEEU, Volume of ICE CDS Clearing, available at https://www.theice.com/clear_credit.jhtml.

563 See generally Darrell Duffie, Ada Li & Theo Lubke, Policy Perspectives on OTC Derivatives Market Infrastructure, at 9 (Fed. Reserve Bank N.Y. Staff Reps., Mar. 2010), available at http://www.newyorkfed.org/research/staff_reports/sr424.pdf ("If a CCP is successful in clearing a large quantity of derivatives trades, the CCP is itself a systemically important financial institution. The failure of a CCP could suddenly expose many major market participants to losses. Any such failure, moreover, is likely to have been triggered by the failure of one or more large clearing members, and therefore to occur during a period of extreme market fragility."); Pirrong, The Inefficiency of Clearing Mandates, Policy Analysis, No. 655, at 11–14, 16–17, 24–26 (2010), available at http://www.cato.org/pubs/pas/PA665.pdf, at 11–14, 16–17, 24–26 (stating, among other things, that "CCPs are concentrated points of potential failure that

result, proper management of the risks associated with central clearing and settlement is necessary to ensure the stability of U.S. securities markets.

The mandated central clearing and settlement of security-based swaps wherever possible and appropriate, a core component of Title VII, reinforces this need.[564] Where a clearing agency provides CCP services, clearing and settlement of security-based swap contracts replaces bilateral counterparty exposures with exposures against the clearing agency providing CCP services. Consequently, a move from voluntary central clearing and settlement of security-based swap contracts to mandatory clearing of security-based swap contracts, holding the volume of security-based swap transactions constant, will increase economic exposures against CCPs that clear security-based swaps. Increased exposures in turn raise the possibility that these CCPs may serve as a transmission mechanism for systemic events.

Clearing agencies have several incentives to implement comprehensive risk management programs. First, the ongoing viability of a clearing agency depends on its reputation and the confidence that market participants have in its services. Clearing agencies therefore have an incentive to minimize the likelihood that a member default or operational outage would disrupt settlement. Second, some clearing agencies, including those that mutualize default risks,

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can create their own systemic risks," that "[a]t most, creation of CCPs changes the topology of the network of connections among firms, but it does not eliminate these connections," that clearing may lead speculators and hedgers to take larger positions, that a CCP's failure to effectively price counterparty risks may lead to moral hazard and adverse selection problems, that the main effect of clearing would be to "redistribute losses consequent to a bankruptcy or run," and that clearinghouses have failed or come close to failing in the past, including in connection with the 1987 market break); Manmohan Singh, Making OTC Derivatives Safe—A Fresh Look, at 5–11 (IMF Working Paper, Mar. 2011), available at http://www.imf.org/external/pubs/ft/wp/2011/wp1166.pdf (addressing factors that could lead central counterparties to be "risk nodes" that may threaten systemic disruption).

564 See supra Part I.B.1.

contribute a portion of their own capital as part of their contingent resources. Clearing agencies with such capital contributions to their contingent resources thus have an economic interest in sound risk management. Registered clearing agencies are SROs that enforce applicable rules and requirements under Commission oversight and are also in certain instances subject to CFTC oversight.[565] Registered clearing agencies consequently also face a legal requirement that their rules be designed to protect the public interest in the process of clearing securities or derivatives.[566]

Nevertheless, clearing agencies' incentives for sound risk management may be tempered by pressures to reduce costs and maximize profits that are distinct from the public interest goals set forth in governing statutes, such as financial stability, and may result in clearing agencies choosing tradeoffs between the costs and benefits of risk management that are not socially efficient. Because the current market for clearing services is characterized by high barriers to entry and limited competition,[567] the market power exercised by clearing agencies in the markets they serve may blunt incentives to invest in risk management systems.[568] Further, even if clearing agencies do internalize costs that they impose on their clearing members, they may fail to internalize the consequences of their risk management decisions on other financial entities that

565 See supra Part I.A and note 96 (describing the Commission's framework for regulation of SROs and the SRO rule filing process); see also supra note 53 (describing regulations adopted by the CFTC for DCOs).

566 See 15 U.S.C. 78q-1(b)(3)(F).

567 See Clearing Agency Standards Release, supra note 5, at 66263.

568 See infra Part IV.C.2.a.

are connected to them through relationships with clearing members.[569] Such a failure represents a financial network externality imposed by clearing agencies on the broader financial markets and suggests that financial stability, as a public good, may be under-produced in equilibrium.

As discussed in more detail below, the proposed amendments to Rule 17Ad-22 represent a strengthening of the Commission's regulation of registered clearing agencies. The Commission preliminarily believes that the more specific requirements imposed by the proposed amendments will further mitigate potential moral hazard associated with risk management at covered clearing agencies. For instance, in the absence of policies and procedures that require periodic stress-testing and validation of credit and liquidity risk models, clearing agencies could potentially choose to recalibrate models in periods of low volatility and avoid recalibration in periods of high volatility, causing them to underestimate the risks they face.

The Commission also preliminarily believes that the additional specificity of proposed Rule 17Ad-22(e), along with proposed testing requirements, would be more effective at mitigating these particular manifestations of incentive misalignments than existing Rule 17Ad-22. The Commission preliminarily believes, as a result, that a general benefit of the proposed amendments would be reductions in the likelihood of CCP failure that result from improved safeguards. This general benefit would be realized to the extent that clearing agencies do not already conform to new requirements under the proposed amendments. Despite the potential incentive problems noted above and perhaps in anticipation of regulatory efforts, some registered clearing agencies have taken steps to update their policies and procedures in accordance with the standards contained in the proposed rules. The Commission notes that in some instances the

569 See Daron Acemoglu, Asuman Ozdaglar & Alireza Tahbaz-Salehi, Systemic Risk and Stability in Financial Networks (NBER Working Paper No. 18727, Jan. 2013), available at http://www.nber.org/papers/w18727.

proposed rules establish as a minimum regulatory requirement certain current practices at some registered clearing agencies. In these cases, the Commission preliminarily believes that imposing the proposed requirements on covered clearing agencies will have the effect of imposing consistent, higher minimum risk management standards across covered clearing agencies.

In analyzing the economic consequences and effects of the rules proposed in this release, the Commission has been guided by the objectives of Section 17A of the Exchange Act to have due regard for the public interest, the protection of investors, the safeguarding of securities and funds, the maintenance of fair competition, and to otherwise further the purposes of the Exchange Act through the registration and regulation of clearing agencies.[570] It has also been guided by the objectives of the Dodd-Frank Act to mitigate risks to the U.S. financial system, promote counterparty protection, increase market transparency for OTC derivatives, and facilitate financial stability.[571] The Commission has also taken into account the importance of maintaining a well-functioning security-based swap market and the objectives of the Clearing Supervision Act to establish an enhanced supervisory and risk control system for systemically important clearing agencies and other FMUs.[572] In addition, as directed by the Clearing Supervision Act, the Commission makes this proposal after giving careful consideration to the

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[570] See supra note 2 and accompanying text (noting the requirements of Section 17A of the Exchange Act).

[571] See supra note 13 and accompanying text (noting the purpose of the Dodd-Frank Act to, among other things, promote financial stability); supra note 14 and accompanying text (noting the purpose of the Dodd-Frank Act to, among other things, create a regulatory framework for the OTC derivatives markets).

[572] See supra Part I.B.2 (describing the regulatory framework for FMUs set forth in the Clearing Supervision Act).

standards set forth in the PFMI Report as the relevant international standard. Proposing rules that maintain consistency with the standards set forth in the PFMI Report may reduce the likelihood that market participants, including members of covered clearing agencies, would restructure in an effort to operate in less-regulated markets.

The Commission preliminarily believes that the proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2 are consistent with the goals of Section 17A of the Exchange Act, to promote the prompt and accurate clearing and settlement of transactions in securities, of the Clearing Supervision Act, to enhance the supervision and oversight of clearing entities, and of Title VII, to create a robust regulatory structure for security-based swaps. In proposing these rules, the Commission is also mindful of the benefits that would accrue through maintaining consistency with regulations adopted by the Board and the CFTC.

The Commission is sensitive to the economic consequences and effects of the proposed rules, including their benefits and costs. In proposing these rules, the Commission has been mindful of the economic consequences of the decisions it makes regarding the scope of applying the proposed rules to covered clearing agencies. Moreover, the Commission acknowledges that, since many of the proposed rules require a covered clearing agency to adopt new policies and procedures, the economic effects and consequences of the proposed rules include those flowing from the substantive results of those new policies and procedures. Under Section 3(f) of the Exchange Act, whenever the Commission engages in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, it must consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[573] Further, as noted above, Section 17A of the Exchange Act directs the Commission to have due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents when using its authority to facilitate the establishment of a national system for clearance and settlement transactions in securities.[574] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.[575] Section 23(a)(2) also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[576]

The Commission has attempted, where possible, to quantify the benefits and costs anticipated to flow from the proposed rules. In some cases, as indicated below, data to quantify the benefits and costs associated with the proposed rules are unavailable. For example, implementing policies and procedures that require stress testing of financial resources available to a covered clearing agency at least once each day may require additional investment in infrastructure, but the particular infrastructure requirements will depend on existing systems and a covered clearing agency's choice of modeling techniques. In other cases, quantification depends heavily on factors outside the control of the Commission, particularly with regard to the

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573 See 15 U.S.C. 78c(f).

574 See supra note 2 and accompanying text (noting the requirements of Section 17A).

575 See 15 U.S.C. 78w(a)(2).

576 See id.

number of potential new entrants affected by the proposed rules that in the future may be designated systemically important by the FSOC.

Overall, the Commission preliminarily believes that the proposed rules represent improvements in risk management, be it systemic, legal, credit, liquidity, general business, custody, investment, or operational risk, in keeping with the requirements of Section 17A of the Exchange Act and the Dodd-Frank Act. The Commission preliminarily believes that the proposed rules will result in an increase in financial stability insofar as they result in minimum standards at covered clearing agencies that are higher than those standards implied by current practices at covered clearing agencies. In particular cases, such as new requirements related to management of liquidity risk and general business risk, stability may arise as a result of higher risk management standards at covered clearing agencies that effectively lower the probability that either covered clearing agencies or their members default. As explained in Part IV.C.2, reduced default probabilities for covered clearing agencies may, in turn, improve efficiency and capital formation.

Request for Comments. The Commission requests comment on all aspects of the economic analysis of the proposed rules, including their benefits and costs, as well as any effect these proposed rules may have on competition, efficiency, and capital formation. Acknowledging the data limitations noted above, the Commission encourages commenters to provide data and analysis to help further quantify or estimate the potential benefits and costs of the proposed rules.

B. Economic Baseline

1. Overview

To assess the economic effects of the proposed rules, including possible effects on efficiency, competition, and capital formation, the Commission is using a baseline composed of

(1) the current regulatory framework under which registered clearing agencies operate,[577] and (2) the current practices of registered clearing agencies as they relate to the rules being proposed today.

More specifically, the baseline includes existing legal requirements applicable to registered clearing agencies providing CCP or CSD services as they exist at the time of this proposal, including applicable rules adopted by the Commission. Rule 17Ad-22 established a regulatory framework for registered clearing agencies, including security-based swap clearing agencies deemed registered pursuant to the Dodd-Frank Act.[578] Section 17A of the Exchange Act generally regulates the national system for clearance and settlement, while Section 19 of the Exchange Act describes the registration, responsibilities, and oversight of SROs. Further, clearing agencies are subject to new requirements related to security-based swaps under the Dodd-Frank Act.

In terms of current practice, registered clearing agencies are required to operate in compliance with the requirements set forth in Rule 17Ad-22, though they may vary in the particular ways they meet these requirements. Some variation in practices across clearing agencies derives from the products they clear and the markets they serve. Additionally, the Commission understands that certain registered clearing agencies have already adopted practices consistent with several of the standards set forth in the PFMI Report. Accordingly, because proposed Rule 17Ad-22(e) and proposed Rule 17Ab2-2 result in general consistency with the standards set forth in the PFMI Report, the Commission preliminarily believes the resulting

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577 A brief summary of the regulatory framework appears in Part IV.B.2. For a more detailed summary of the current regulatory framework, see Part I.

578 See Clearing Agency Standards Release, supra note 5; see also supra note 25 and accompanying text (discussing the deemed registered provision).

benefits and costs to covered clearing agencies would, in some cases, be incremental because of the relationship between existing requirements applicable to registered clearing agencies,[579] the anticipation of new requirements consistent with the standards set forth in the PFMI Report,[580] and the CPSS-IOSCO Recommendations that preceded the PFMI Report.[581] In certain other cases, such as management of liquidity risk and general business risk, registered clearing agencies that are covered clearing agencies would be required to make changes to current policies and procedures, so the resulting costs, benefits and economic effects may be significant.

In order to consider the broader implications of these proposed rules on market activity, including possible effects on efficiency, competition, and capital formation, the baseline also considers the current state of clearing and settlement services, including the number of registered clearing agencies, the distribution of members across these clearing agencies, and the volume of transactions these clearing agencies process. There are currently six registered clearing agencies that provide CCP services and one registered clearing agency that provides CSD services. As shown in Table 1, membership rates vary across these clearing agencies. Together, registered clearing agencies processed over $2 quadrillion in financial market transactions in 2012.[582]

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579 See supra Part I.C (discussing existing requirements under Rule 17Ad-22).

580 See supra note 49.

581 See supra note 50 and accompanying text.

582 See, e.g., CME Group, 2012 Annual Report, at 2, available at http://www.cmegroup.com/investor-relations/annual-review/2012/downloads/cme-group-2012-annual-report.pdf (indicating $806 trillion notional in trading volume); DTCC, 2012 Annual Report, available at http://www.dtcc.com/about/annual-report.aspx (indicating $1.6 quadrillion in transactions cleared).

Table 1: Membership statistics for registered clearing agencies:[583]

		Number
CME	Total Members	72
	- Of which clear CDS	14
DTC	Full Service Members	272
FICC	GSD Members	107
	MBSD Members	76
ICE	Clear Credit Members	28
	Clear Europe Members	79
	- Clear Europe Members that clear CDS	18
NSCC	Full Service Members	175
OCC	Total Members	117

Registered clearing agencies are currently characterized by specialization and limited competition. Clearing and settlement services exhibit high barriers to entry and economies of scale. These features of the existing market, and the resulting concentration of clearing and settlement within a handful of entities, informs our examination of effects of the proposed amendments and rules on competition, efficiency, and capital formation.[584]

583 Membership statistics are taken from the websites of each of the listed clearing agencies and are current, for CME and ICE, as of October 2013; for FICC, including the Government Securities Division ("GSD") and the Mortgage-Backed Securities Division ("MBSD"), as of September 2013; for OCC as of January 2014; and for DTC and NSCC as of December 6, 2013.

584 See infra Part IV.C.2 (discussing the effect of the proposed rules on competition, efficiency, and capital formation).

2. Current Regulatory Framework for Clearing Agencies

The proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2 fit within the Commission's broad approach to regulation of the national system for clearance and settlement that comprises the baseline for the Commission's economic analysis. Key elements of the current regulatory framework for registered clearing agencies are Section 17A of the Exchange Act,[585] Titles VII and VIII of the Dodd-Frank Act, and existing Rule 17Ad-22. Section 17A of the Exchange Act directs the Commission to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and the maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents.[586]

Title VII, in response to the 2008 financial crisis, provides the Commission and the CFTC with authority to regulate the mandatory exchange trading and central clearing and settlement of swaps that formerly may have been OTC derivatives.[587] Title VII amended Section 17A of the Exchange Act by adding new paragraphs (g) through (j) requiring the registration of clearing agencies serving the security-based swap market, giving the Commission authority to adopt rules governing security-based swap clearing agencies, and requiring compliance by registered clearing agencies with said rules. New Section 17A(i) of the Exchange Act provides

585 See 15 U.S.C. 78q-1. For a more detailed discussion of the regulatory framework for registered clearing agencies under Section 17A of the Exchange Act, see Part I.A.

586 See supra note 2 and accompanying text (noting the requirements of Section 17A of the Exchange Act).

587 See Dodd-Frank Act, 124 Stat. at 1641–1802. For a more detailed discussion of the regulatory framework for registered clearing agencies under Title VII, see Part I.B.1.

that the Commission may conform standards for and oversight of clearing agencies to reflect evolving international standards.

The Clearing Supervision Act, adopted in Title VIII, provides for enhanced regulation of FMUs, such as clearing agencies, and for enhanced coordination between the Commission, the CFTC, and the Board by facilitating examinations and information sharing.[588] It also requires the Commission and the CFTC to coordinate with the Board to develop risk management supervision programs for clearing agencies designated systemically important. Section 805(a) of the Clearing Supervision Act further provides that the Commission, considering relevant international standards and existing prudential requirements, may prescribe regulations that contain risk management standards for designated clearing agencies or the conduct of designated activities by a financial institution.

Rule 17Ad-22 under the Exchange Act, adopted in 2012, requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis. These requirements are designed to work in tandem with the SRO rule filing process and the requirement in Section 17A that the Commission must make certain determinations regarding a clearing agency's rules and operations for purposes of initial and ongoing registration.[589] In its economic analysis of the rule, the Commission noted

588 See 12 U.S.C. 5461 et seq. For a more detailed discussion of the regulatory framework for registered clearing agencies under Title VIII, see Part I.B.2.

589 See Clearing Agency Standards Release, supra note 5. For a more detailed discussion of the regulatory framework for registered clearing agencies under Rule 17Ad-22, see Part I.C. For a comparison of the requirements under proposed Rule 17Ad-22(e) and existing requirements under Rule 17Ad-22, see Part II.A.4. For further discussion of current industry practices subject to the requirements in Rule 17Ad-22, see Part IV.B.3.

that the economic characteristics of clearing agencies, including economies of scale, barriers to entry, and the particulars of their legal mandates, may limit competition and confer market power on such clearing agencies, which may lead to lower levels of service, higher prices, or under-investment in risk management systems.[590] To address these potential market failures, Rule 17Ad-22 was adopted to strengthen the substantive regulation of clearing agencies, promote the safe and reliable operation of clearing agencies, improve efficiency, transparency, and access to clearing agencies, and promote consistency with international standards.[591] Part IV.B.3 discusses current practices at registered clearing agencies related to the requirements under Rule 17Ad-22.

a. Basel III Capital Requirements

In addition to requirements under the Exchange Act, the Dodd-Frank Act, and Rule 17Ad-22, other regulatory efforts are relevant to our analysis of the economic effects of proposed Rule 17Ad-22(e). In July 2012, the BCBS published the Basel III capital requirements, which set forth interim rules governing the capital charges arising from bank exposures to CCPs related to OTC derivatives, exchange-traded derivatives, and securities financing transactions.[592] Once in effect, the Basel III capital requirements will create incentives for banks to clear derivatives and securities financing transactions with CCPs licensed in a jurisdiction where the relevant regulator has adopted rules or regulations consistent with the standards set forth in the PFMI Report. Specifically, the Basel III capital requirements introduce new capital charges based on

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590 See id.

591 See Clearing Agency Standards Release, supra note 5, at 66225, 66263–64.

592 See supra note 48 (discussing the Basel III capital requirements). For a more detailed discussion of the Basel III framework, see Part IV.C.1.e.

counterparty risk for banks conducting derivatives transactions or securities financing transactions through a CCP.[593]

New capital charges under the Basel III framework relate to a bank's trade exposure and default fund exposure to a CCP and are a function of multiplying these exposures by a corresponding risk weight. Historically, these exposures have carried a risk weight of zero. As banking regulators adopt rules consistent with the Basel III capital requirements, however, these weights will increase. The risk weight assigned under the Basel III capital requirements varies depending on whether the counterparty is a QCCP. For example, risk weights for trade exposures to a CCP generally would vary between 20% and 100% depending on the CCP's credit quality, while trade exposures to a QCCP would carry only a 2% risk weight.[594] In addition, bank exposures to CCP default funds would carry a risk weight of 1250%. While bank exposures to QCCP default funds will also carry a 1250% risk weight at low levels, under the Basel III framework, default fund exposures' contribution to a bank's risk weighed assets will be limited to at most 18% of the bank's trade exposures to a given QCCP.

In some jurisdictions, banking regulators have already adopted rules that implement many requirements under the Basel III framework. For example, in its Capital Requirements Directive IV, which went into effect on July 17, 2013, the E.U. incorporated into its own legal

593 Since the Basel III framework applies lower capital requirements only to bank exposures related to OTC and exchange-traded derivatives activity and securities financing transactions, the Commission currently expects that, among all registered clearing agencies, FICC, ICEEU, and OCC would be those affected by the Basel III capital requirements. Each would meet the proposed definition of "covered clearing agency."

594 The Basel III framework and rules adopted by the Board and the Office of the Comptroller of the Currency consistent with that framework apply lower risk weights of 2% or 4% to indirect exposures of banks to QCCPs. See Basel III capital requirements, supra note 59, paras. 114–15; Regulatory Capital Rules, supra note 53, at 62103.

framework the Basel III framework. Article 301 contains rules governing bank exposures to CCPs that are consistent with the Basel III framework. Similarly, the BCBS reports that the Basel III capital requirements, with the exception of capital conservation buffers and countercyclical buffers, are currently in force for Japanese banks.[595] Canada and Switzerland also have risk-based capital rules in place.[596]

In the United States, on July 9, 2013, the Board and the Office of the Comptroller of the Currency jointly issued regulatory capital rules for U.S. banks consistent with the Basel III framework. Upon its effective date of January 1, 2014, the Regulatory Capital Rules subject bank exposures to CCPs and QCCPs to increased risk weights as specified in the Basel III framework.[597] In addition to specifying risk weights, the rules define the term QCCP for banks supervised by the Board and the Office of the Comptroller of the Currency.[598] According to these rules, QCCP status applies to any CCP that is a designated FMU. Further, any CCP that (i) requires full collateralization of contracts on a daily basis, and (ii), as demonstrated to the satisfaction of its supervisory regulator, is in sound financial condition, is subject to supervision by the Commission, and meets or exceeds the risk management standards established by the Commission under Titles VII and VIII of the Dodd-Frank Act, is a QCCP. Based on this definition, for banks regulated by the Board and the Office of the Comptroller of the Currency,

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595 See BCBS, Progress Report on Implementation of the Basel Regulatory Framework (Oct. 2013), available at http://www.bis.org/bcbs/implementation/bprl1.htm.

596 See id.

597 See Regulatory Capital Rules, supra note 53.

598 See id.

all covered clearing agencies, with the exception of ICEEU,[599] will be considered QCCPs for purposes of calculating risk weights for trade exposures and default fund exposures.

In Europe, under EMIR, legal persons incorporated under the law of an E.U. member state will only be able to use non-E.U. CCPs if those CCPs have been recognized under EMIR. Further, only non-E.U. CCPs recognized under EMIR will meet the conditions necessary to be considered a QCCP for E.U. purposes. Article 25 of EMIR outlines a recognition procedure for non-E.U. CCPs and Article 89 provides a timeline for recognition.[600] FICC, NSCC, and OCC applied for recognition under EMIR prior to a September 15, 2013 deadline.[601] As a result of applying for recognition, these covered clearing agencies will be permitted to continue to offer clearing services to existing E.U. clearing members until their applications are accepted or rejected.

Additionally, the Basel III capital requirements, as adopted by the Board, the Office of the Comptroller of the Currency, and banking regulators in other jurisdictions, impose new

599 Although ICEEU would not be subject to QCCP treatment as a designated FMU, it would nonetheless be considered a QCCP because it is subject to regulation by the Commission. See Regulatory Capital Rules, supra note 53, at 62166 (defining "Qualifying Central Counterparty" at 1.iii(B)(2)).

600 See Eur. Comm'n, Practical Implementation of the EMIR Framework to Non-EU Central Counterparties (CCPs) (May 13, 2013), available at http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/130513_equivalence-procedure_en.pdf.

601 These three clearing agencies agreed to have their names publicly disclosed and do not necessarily represent the full set of registered clearing agencies that applied for recognition under EMIR. See ESMA, List of Central Counterparties (CCPs) Established in Non-EEA Countries Which Have Applied for Recognition Under Article 25 of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories (TRs) (EMIR) (Dec. 16, 2013), available at http://www.esma.europa.eu/system/files/2013-1581_list_of_applicants_tc-ccps_version_16_december_2013.pdf.

capital requirements related to unconditionally cancellable commitments and other off-balance sheet exposures. For example, the Board and the Office of the Comptroller of the Currency will require banks to include 10% of the notional amount of unconditionally cancellable commitments in their calculation of total leverage exposure.[602] The rules cap the ratio of tier one capital to total leverage exposure at 3% for banks subject to advanced approaches risk-based capital rules.[603] To the extent that clearing agencies rely on financial resources from banks as part of their risk management activities, new constraints on off-balance sheet exposures could raise the cost of these activities.

b. Other Regulatory Efforts

Efforts by the Board and the CFTC to adopt rules that are consistent with the standards set forth in the PFMI Report are also relevant to the economic analysis of the proposed rules.[604] In 2012, the Board adopted Regulation HH setting forth risk management standards for designated FMUs, and, on January 10, 2014, the Board proposed amendments to Regulation HH and its PSR Policy based upon the standards set forth in the PFMI Report.[605] Similarly, the CFTC has published final rules intended to be consistent with the standards set forth in the PFMI Report.[606]

602 See Regulatory Capital Rules, supra note 53, at 62169.

603 See id. at 62284. The Regulatory Capital Rules require compliance by banks no later than 2018.

604 For a more detailed discussion of the regulatory efforts undertaken by the Board and the CFTC, see note 53.

605 See id.

606 See id.

In proposing the amendments to Rule 17Ad-22 and new Rule 17Ab2-2, the Commission is mindful of these regulations proposed by the Board and adopted by the CFTC, which seek to establish standards for designated FMUs and establish standards for certain DCOs, respectively.[607] Section 712(a)(2) of Title VII requires the Commission, before commencing any rulemaking regarding, among other things, security-based swap clearing agencies, to consult and coordinate to the extent possible with the CFTC and prudential regulators for the purposes of assuring regulatory consistency and comparability where possible.[608] In addition, as directed by the Clearing Supervision Act, the Commission is proposing these amendments to Rule 17Ad-22 and Rule 17Ab2-2 after giving careful consideration to the PFMI Report as the relevant international standard.

3. Current Practices

Current industry practices are a critical element of the economic baseline for registered clearing agencies. Registered clearing agencies are required to operate in compliance with existing Rule 17Ad-22 and, the Commission understands, have begun implementing some of the standards set forth in the PFMI Report. Because proposed Rule 17Ad-22(e) is consistent with those standards and furthers the objectives of Section 17A of the Exchange Act, the Clearing Supervision Act, and Title VII of the Dodd-Frank Act, the Commission preliminarily believes that the proposed rule represents, where it imposes higher minimum standards on covered clearing agencies, an additional step towards improved risk management.

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607 See id. (discussing efforts by the Board and the CFTC to adopt rules consistent with the standards set forth in the PFMI Report).

608 See Dodd-Frank Act, Sec. 712(a)(2), Pub. L. No. 111-203, 124 Stat. 1376, 1641–42 (2010).

An overview of current practices is set forth below and includes discussion of covered clearing agency policies and procedures regarding general organization and risk management, including the management of legal, credit, liquidity, business, custody, investment, and operational risk. This discussion is based on the Commission's general understanding of current practices as of the date of this proposal, reflects the Commission's experience supervising registered clearing agencies, and is intended solely for the purpose of analyzing the economic effects of the Commission's proposal. The Commission notes that in each case, as SROs, registered clearing agencies are required to submit any proposed rule or any proposed change in, addition to, or deletion from the rules of the clearing agency to the Commission for review.[609] The Exchange Act also requires a registered clearing agency to enforce its rules, subject to Commission oversight, and empowers the Commission to enforce the rules of a registered clearing agency.[610]

a. General Organization

i. Legal Risk

Legal risk is the risk that a registered clearing agency's rules, policies, or procedures may not be enforceable and concerns, among other things, its contracts, the rights of members, netting arrangements, discharge of obligations, and settlement finality. Cross-border activities of a registered clearing agency may also present elements of legal risk.

609 See supra Part I.A and note 95 (describing the Commission's framework for regulation of SROs and the SRO rule filing process).

610 See supra Part I.A, in particular notes 8–10 (describing the requirements applicable to registered clearing agencies under the Exchange Act and the supervisory and enforcement tools available to the Commission to facilitate compliance with those requirements under the Exchange Act).

Rule 17Ad-22(d)(1) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, transparent, and enforceable legal framework for each aspect of its activities in all relevant jurisdictions.[611] Each registered clearing agency makes a large portion of these policies and procedures available to members and participants. In addition, each also publishes their rule books and other key procedures publicly in order to promote the transparency of their legal framework.[612]

ii. Governance

Rule 17Ad-22(d)(8) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Exchange Act applicable to clearing agencies, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures.[613] Important elements of a registered clearing agency's governance arrangements include its ownership structure; its charter, bylaws, and charters for committees of its board and management committees; its rules, policies, and procedures; the composition and role of its board, including the structure and role of board committees; reporting lines between

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611 See 17 CFR 240.17Ad-22(d)(1); Clearing Agency Standards Release, supra note 5, at 66245–46.

612 The rule book of each registered clearing agency, as well as select policies and procedures, are publically available on each registered clearing agency's website.

613 See 17 CFR 240.17Ad-22(d)(8); see also Clearing Agency Standards Release, supra note 5, at 66251–52.

management and the board; and the processes that provide for management accountability with respect to the registered clearing agency's performance.

Each registered clearing agency has a board that governs its operations and supervises senior management. Each registered clearing agency also has an independent audit committee of the board and has established a board committee or committee of members tasked with overseeing the clearing agency's risk management functions. The boards of registered clearing agencies that would be subject to proposed Rule 17Ad-22(e) as covered clearing agencies currently include non-management members.

iii. Framework for the Comprehensive Management of Risks

Rules 17Ad-22(b) and (d) require registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to measure and mitigate credit exposures, identify operational risks, evaluate risks arising in connection with cross-border and domestic links for the purpose of clearing or settling trades, achieve DVP settlement, and implement risk controls to cover the clearing agency's credit exposures to participants.[614] Rule 17Ad-22(d)(4) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish business continuity plans setting forth procedures for the recovery of operations in the event of a disruption.[615] Rule 17Ad-22(d)(11) further requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to make key aspects of the clearing agency's default procedures publicly available and establish

614 See 17 CFR 240.17Ad-22(b) and (d); see also Clearing Agency Standards Release, supra note 5.

615 See 17 CFR 240.17Ad-22(d)(4); see also Clearing Agency Standards Release, supra note 5, at 66248–49.

default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default.[616]

In addition to meeting these requirements, the Commission understands that registered clearing agencies also specify actions to be taken when their resources are insufficient to cover losses faced by the registered clearing agency.[617] These actions may include assessment rights on clearing members, forced allocation, and contract termination.

b. Financial Risk Management

Registered clearing agencies that provide CCP services have a variety of options available to mitigate the financial risks to which they are exposed. While the manner in which a CCP chooses to mitigate these financial risks depends on the precise nature of the CCP's obligations, a common set of procedures have been implemented by many CCPs to manage credit and liquidity risks. Broadly, these procedures enable CCPs to manage their risks by reducing the likelihood of member defaults, limiting potential losses and liquidity pressure in the event of a member default, implementing mechanisms that allocate losses across members, and providing adequate resources to cover losses and meet payment obligations as required.

Registered clearing agencies that provide CCP services must be able to effectively measure their credit exposures in order to properly manage those exposures. A CCP faces the risk that its exposure to a member can change as a result of a change in prices, positions, or both.

616 See 17 CFR 240.17Ad-22(d)(11).

617 See David Elliot, Central Counterparty Loss-Allocation Rules, at tbl. 1A (Bank of England Financial Stability Paper No. 20, Apr. 2013), available at http://www.bankofengland.co.uk/research/Documents/fspapers/fs_paper20.pdf (noting the loss-allocation rules applied at the end of a clearing agency waterfall).

CCPs can ascertain current credit exposures to each member by, in some cases, marking each member's outstanding contracts to current market prices and, to the extent permitted by their rules and supported by law, by netting any gains against any losses. Rule 17Ad-22 includes certain requirements related to financial risk management by CCPs, including requirements to measure credit exposures to members and to use margin requirements to limit these exposures. These requirements are general in nature and provide registered clearing agencies flexibility to measure credit risk and set margin. Within the bounds of Rule 17Ad-22, CCPs may employ models and choose parameters that they conclude are appropriate to the markets they serve.

The current practices of registered clearing agencies that provide CCP services generally include the following procedures: (1) measuring credit exposures at least once a day; (2) setting margin coverage at a 99% confidence level over some set period; (3) using risk-based models; (4) establishing a fund that mutualizes losses of defaults by one or more participants that exceed margin coverage; (5) maintaining sufficient financial resources to withstand the default of at least the largest participant family,[618] and (6), in the case of security-based swap transactions;

618 See, e.g., IMF, Publication of Financial Sector Assessment Program Documentation—Detailed Assessment of Observance of the National Securities Clearing Corporation's Observance of the CPSS-IOSCO Recommendations for Central Counterparties, at 10 (May 2010), available at http://www.imf.org/external/pubs/ft/scr/2010/cr10129.pdf (assessing NSCC's observance of Recommendation 5 from the RCCP that a CCP should maintain sufficient financial resources to withstand, at a minimum, the default of a participant to which it has the largest exposure in extreme but plausible market conditions; also noting that NSCC began evaluating itself against this standard in 2009 and has backtesting results to support that it maintained sufficient liquidity to cover the failure of the largest affiliated family 99.98% of the time during the period from January through April 2009); IMF, Publication of Financial Sector Assessment Program Documentation—Detailed Assessment of Observance of the Fixed Income Clearing Corporation – Government Securities Division's Observance of the CPSS-IOSCO Recommendations for Central Counterparties, at 9–10 (2010), available at http://www.imf.org/external/pubs/ft/scr/2010/cr10130.pdf (finding that FICC's Government Securities Division observed the requirement to maintain enough financial resources to meet the default of its largest participant in extreme but plausible market conditions).

maintaining enough financial resources to be able to withstand the default of their two largest participant families.[619]

i. Credit Risk

Rule 17Ad-22(b)(1) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to measure their credit exposures at least once per day.[620] Several CCPs have policies and procedures designed to require measuring credit exposures multiple times per day.

Rule 17Ad-22(b)(3) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions.[621] It further requires CCPs for security-based swaps to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain additional financial resources sufficient to withstand, at a minimum, a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions, in its capacity as a CCP for

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619 See, e.g., CFTC-SEC Staff Roundtable on Clearing of Credit Default Swaps, at 123 (Oct. 2010), available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission7_102210-transcrip.pdf (Stan Ivanov of ICE stating, "[A]t ICE we look at two simultaneous defaults of the two biggest losers upon extreme conditions . . . ."); see also ICE, CDS Client Clearing Overview, at 8 (Aug. 2013), available at https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Client_Clearing_Overview.pdf (noting that the guaranty fund covers the simultaneous default of the two largest clearing members); CME Rulebook, Ch. 8H, Rule 8H07, available at http://www.cmegroup.com/rulebook/CME/I/8H/8H.pdf.

620 See 17 CFR 240.17Ad-22(b)(1).

621 See 17 CFR 240.17Ad-22(b)(2).

security-based swaps.[622] Accordingly, the Commission notes that Rule 17Ad-22(b)(3) imposes a "cover two" requirement on CCPs for security-based swaps in order to protect such CCPs from the extreme jump-to-default risk and nonlinear payoffs associated with the nature of the financial products they clear and the participants in the markets they serve. Meanwhile, CCPs that clear products other than security-based swaps are subject to a "cover one" requirement.[623] Rule 17Ad-22(b)(3) also states that such policies and procedures may provide that additional financial resources be maintained by the CCP in combined or separately maintained funds.[624]

Under existing rules, CCPs collect contributions from their members for the purpose of establishing guaranty or clearing funds to mutualize losses under extreme but plausible market conditions. Currently, the guaranty funds or clearing funds consist of liquid assets and their sizes vary depending on a number of factors, including the products the CCP clears and the characteristics of CCP members. In particular, the guaranty funds for CCPs that clear security-based swaps are relatively larger, as measured by the size of the fund as a percentage of the total and largest exposures, than the guaranty or clearing funds maintained by CCPs for other financial instruments. CCPs generally take the liquidity of collateral into account when determining member obligations. Applying haircuts to assets posted as margin, among other things, mitigates the liquidity risk associated with selling margin assets in the event of a participant default.

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622 See id.

623 See supra Part II.B.4.c and infra Part IV.C.3.a.iv(1) (discussing the related "cover one" and "cover two" requirements in proposed Rule 17Ad-22(e)(4)).

624 See id.

ii. Collateral and Margin

Rule 17Ad-22(b)(2) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit their exposures to participants.[625] This margin can also be used to reduce a CCP's losses in the event of a participant default.

Registered clearing agencies that provide CCP services take positions as substituted counterparties once their trade guarantee goes into effect. Therefore, if a counterparty whose obligations the registered clearing agency has guaranteed defaults, the covered clearing agency may face market risk, which can take one of two forms. First, a covered clearing agency is subject to the risk of movement in the market prices of the defaulting member's open positions. Where a seller defaults and fails to deliver a security, the covered clearing agency may need to step into the market to buy the security in order to complete settlement and deliver the security to the buyer. Similarly, where a buyer defaults, the covered clearing agency may need to meet payment obligations to the seller. Thus, in the interval between when a member defaults and when the covered clearing agency must meet its obligations as a substituted counterparty in order to complete settlement, market price movements expose the covered clearing agency to market risk. Second, the covered clearing agency may need to liquidate non-cash margin collateral posted by the defaulting member. The covered clearing agency is therefore exposed to the risk that erosion in market prices of the collateral posted by the defaulting member could result in the covered clearing agency having insufficient financial resources to cover the losses in the defaulting member's open positions.

625 See 17 CFR 240.17Ad-22(b)(2).

To manage their exposure to market risk resulting from fulfilling a defaulting member's obligations, registered clearing agencies compute margin requirements using inputs such as portfolio size, volatility, and sensitivity to various risk factors that are likely to influence security prices. Moreover, since the size of price movements is, in part, a function of time, registered clearing agencies may limit their exposure to market risk by marking participant positions to market daily and, in some cases, more frequently. CCPs also use similar factors to determine haircuts applied to assets posted by members in satisfaction of margin requirements. To manage market risk associated with collateral liquidation, CCPs consider the current prices of assets posted as collateral and price volatility, asset liquidity, and the correlation of collateral assets and a member's portfolio of open positions. Further, because CCPs need to value their margin assets in times of financial stress, their rulebooks may include features such as market-maker domination charges that increase clearing fund obligations regarding open positions of members in securities in which the member serves as a dominant market maker. The reasoning behind this charge is that, should a member default, liquidity in products in which the member makes markets may fall, leaving these positions more difficult to liquidate for non-defaulting participants.

Rule 17Ab-22(b)(2) also requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for risk-based models and parameters to set margin requirements.[626] The generally recognized standard for such models and parameters is, under normal market conditions, price movements that produce changes in exposures that are expected to breach margin requirements or other risk controls only 1% of the time (i.e., at a 99% confidence

626 See id.

interval) over a designated time horizon.[627] Currently, CCPs use margin models to ensure coverage at a single-tailed 99% confidence interval. Losses beyond this level are typically covered by the CCP's guaranty fund. This standard comports with existing international standards for bank capital requirements, which require banks to measure market risks at a 99% confidence interval when determining regulatory capital requirements.[628]

Rule 17Ad-22(b)(2) also requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to review such margin requirements and the related risk-based models and parameters

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627 See 17 CFR 240.17Ad-22(a)(4). The Commission notes that because it is proposing to add new definitions to Rule 17Ad-22(a), "normal market conditions" would appear in Rule 17Ad-22(a)(12) in the event the proposed rules are adopted. The Commission is not proposing to alter the definition of "normal market conditions."

628 See BCBS, International Convergence of Capital Measurement and Capital Standards: A Revised Framework (June 2004), available at http://www.bis.org/publ/bcbs107.pdf; see also Darryll Hendricks & Beverly Hirtle, New Capital Rule Signals Supervisory Shift (Secondary Mortgage Mkts, Sept. 1998), available at http://www.freddiemac.com/finance/smm/july98/pdfs/hen_hirt.pdf.

Prior to this standard, banks measured value-at-risk using a range of confidence intervals from 90–99%. See BCBS, An Internal Model-Based Approach to Market Risk Capital Requirements, at 12 (Apr. 1995), available at http://www.bis.org/publ/bcbs17.pdf. When determining the minimum quantitative standards for calculating risk measurements, the BCBS noted then the importance of specifying "a common and relatively conservative confidence level," choosing the 99% confidence interval over other less conservative measures. See id.

Since its adoption in 1998, the standard has become a generally recognized practice of banks to quantify credit risk as the worst expected loss that a portfolio might incur over an appropriate time horizon at a 99% confidence interval. See Kenji Nishiguchi, Hiroshi Kawai & Takanori Sazaki, Capital Allocation and Bank Management Based on the Quantification of Credit Risk, at 83 (FRBNY Econ. Policy Rev., Oct. 1998), available at http://www.newyorkfed.org/research/epr/98v04n3/9810nish.pdf; Jeff Aziz & Narat Charupat, Calculating Credit Exposure and Credit Loss: A Case Study, at 34 (Sept. 1998), available at http://www.bis.org/bcbs/ca/alrequse98.pdf.

at least monthly.[629] CCPs are accordingly required to establish a model validation process that evaluates the adequacy of margin models, parameters, and assumptions. Additionally, CCPs are required to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for an annual model validation consisting of evaluating the performance of the CCPs' margin models and the related parameters and assumptions associated with such models by a qualified person who is free from influence from the persons responsible for the development or operation of the models being validated.[630]

iii. Liquidity Risk

In addition to credit risk and the aforementioned market risk, registered clearing agencies also face liquidity or funding risk. Currently, to complete the settlement process, registered clearing agencies that employ netting rely on incoming payments from participants in net debit positions in order to make payments to participants in net credit positions. If a participant does not have sufficient funds or securities in the form required to fulfill a payment obligation immediately when due (even though it may be able to pay at some future time), or if a settlement bank is unable to make an incoming payment on behalf of a participant, a registered clearing agency may face a funding shortfall. Such funding shortfalls may occur due to a lack of financial resources necessary to meet delivery or payment obligations, however even registered clearing agencies that do hold sufficient financial resources to meet their obligations may not carry those in the form required for delivery or payments to participants.

A registered clearing agency that provides CCP services may hold additional financial resources to cover potential funding shortfalls in the form of collateral. As noted above, CCPs

629 See 17 CFR 240.17Ad-22(b)(2).

630 See 17 CFR 240.17Ad-22(b)(4).

may take the liquidity of collateral into account when determining member obligations. Applying haircuts to illiquid assets posted as margin mitigates the liquidity risk associated with selling margin assets in the event of participant default. Some registered CCPs also arrange for liquidity provision from other financial institutions using lines of credit. Additionally, some registered clearing agencies enter into prearranged funding agreements with their members pursuant to their rules. For example, members of one registered clearing agency are obligated to enter into repurchase agreements against securities that would have been delivered to a defaulting member.

No rule under the Exchange Act currently requires a registered clearing agency through its written policies and procedures to address liquidity risk.

c. Settlement

Rule 17Ad-22(d)(5) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to employ money settlement arrangements that eliminate or strictly limit the clearing agency's settlement bank risks and require funds transfers to the clearing agency to be final when effected.[631] Rule 17Ad-22(d)(12) further requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that final settlement occurs no later than the end of the settlement day.[632] Accordingly, for example, certain registered clearing agencies provide for final settlement of securities transfers no later than the end of the day of the transaction. Rule 17Ad-22(d)(15) also requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably

[631] See 17 CFR 240.17Ad-22(d)(5).

[632] See 17 CFR 240.17Ad-22(d)(12).

designed to state to its participants the clearing agency's obligations with respect to physical deliveries and identify and manage the risks from these obligations.[633]

d. CSDs and Exchange-of-Value Settlement Systems

i. CSDs

Rule 17Ad-22(d)(10) requires a registered clearing agency that provides CSD services to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain securities in an immobilized or dematerialized form for transfer by book entry to the greatest extent possible. Currently, some securities, such as mutual fund securities and government securities, are issued primarily or solely on a dematerialized basis. Dematerialized shares do not exist as physical certificates but are held in book entry form in the name of the owner (which, where the master security holder file is not maintained on paper due to the use of technology, is also referred to as electronic custody). Other types of securities may be issued in the form of one or more physical security certificates, which could be held by the CSD to facilitate immobilization. Alternatively, securities may be held by the beneficial owner in record name, in the form of book-entry positions, where the issuer offers the ability for a security holder to hold through the direct registration system. Whether immobilization occurs at the CSD or through direct registration depends on what is provided for by the issuer.

When a trade occurs, the depository's accounting system credits one participant account and debits another participant account. Transactions between counterparties in dematerialized shares are recorded by the registrar responsible for maintaining the paper or electronic register of security holders, such as by a transfer agent, and reflected in customer accounts.

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633 See 17 CFR 240.17Ad-22(d)(15).

Registered CSDs currently reconcile ownership positions in securities against CSD ownership positions on the security holders list daily, mitigating the risk of unauthorized creation or deletion of shares.

ii. Exchange-of-Value Settlement Systems

Rule 17Ad-22(d)(13) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to eliminate principal risk by linking securities transfers to funds transfers in a way that achieves delivery versus payment,[634] which serves to link obligations by conditioning the final settlement of one upon the final settlement of the other. One registered clearing agency, for example, operates a Model 2 DVP system that provides for gross securities transfers during the day followed by an end-of-day net funds settlement. Under the rules governing the clearing agency's system, the delivering party in a DVP transaction is assured that it will be paid for the securities once they are credited to the receiving party's securities account. DVP eliminates the risk that a buyer would lose the purchase price of a security purchased from a defaulting seller or that a seller would lose the sold security without receiving payment for a security acquired by a defaulting buyer.

For example, one registered clearing agency has rules governing its continuous net settlement ("CNS") system, under which it becomes the counterparty for settlement purposes at the point its trade guarantee attaches, thereby assuming the obligation of its members that are receiving securities to receive and pay for those securities, and the obligation of members that are delivering securities to make the delivery. Unless the clearing agency has invoked its default rules, it is not obligated to make those deliveries until it receives from members with delivery

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634 See 17 CFR 240.17Ad-22(d)(13); see also Clearing Agency Standards Release, supra note 5, at 66256.

obligations deliveries of such securities; rather, deliveries that come into CNS ordinarily are promptly redelivered to parties that are entitled to receive them through an allocation algorithm. Members are obligated to take and pay for securities allocated to them in the CNS process. These rules also provide mechanisms to allow receiving members a right to receive high priority in the allocation of deliveries, and also permit a member to buy-in long positions that have not been delivered to it by the close of business on the scheduled settlement date.

e. Default Management

i. Participant-Default Rules and Procedures

Rule 17Ad-22(d)(11) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to make key aspects of its default procedures publicly available and establish default procedures that ensure it can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default. The rules of registered clearing agencies typically state what constitutes a default, identify whether the board or a committee of the board may make that determination, and describe what steps the clearing agency may take to protect itself and its members. In this regard, registered clearing agencies typically attempt, among other things, to hedge and liquidate a defaulting member's positions. Rules of registered clearing agencies also include information about the allocation of losses across available financial resources.

ii. Segregation and Portability

No rule under the Exchange Act currently requires a registered clearing agency through its written policies and procedures to enable the portability of positions of a member's customers and the collateral provided in connection therewith. Additionally, no rule under the Exchange

Act currently requires a registered clearing agency through its written policies and procedures to protect the positions of a member's customers from the default or insolvency of the member.[635]

f. General Business and Operational Risk Management

i. General Business Risk

Business risk refers to the risks and potential losses arising from a registered clearing agency's administration and operation as a business enterprise that are neither related to member default nor separately covered by financial resources designated to mitigate credit or liquidity risk. While Rule 17Ad-22 sets forth requirements for registered clearing agencies to identify, monitor, and mitigate or eliminate a broad array of risks through written policies and procedures, no rule under the Exchange Act expressly requires a registered clearing agency through its written policies and procedures to identify, monitor, and manage general business risk or to meet a capital requirement. Nonetheless, registered clearing agencies currently have certain internal controls in place to mitigate business risk. Some clearing agencies, for instance, have policies and procedures that identify an auditor who is responsible for examining accounts, records, and transactions, as well as other duties prescribed in the audit program. Other registered clearing agencies allow members to collectively audit the books of the clearing agency on an annual basis, at their own expense.

ii. Custody and Investment Risks

Registered clearing agencies face default risk from commercial banks that they use to effect money transfers among participants, to hold overnight deposits, and to safeguard collateral. Rule 17Ad-22(d)(3) requires a registered clearing agency to establish, implement,

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[635] See supra note 293 (discussing existing rules applicable to registered broker-dealers that address customer security positions and funds in cash securities and listed option markets, thereby promoting segregation and portability at the broker-dealer level).

maintain and enforce written policies and procedures reasonably designed to (i) hold assets in a manner that minimizes risk of loss or delay in its access to them; and (ii) invest assets in instruments with minimal credit, market, and liquidity risks.[636] Registered clearing agencies currently seek to minimize the risk of loss or delay in access by holding assets that are highly liquid (e.g., cash, U.S. Treasury securities, or securities issued by a U.S. government agency) and by engaging banks to custody the assets and facilitate settlement. Typically, registered clearing agencies take steps to ensure that assets held in custody are protected from claims from the custodian's creditors using trust accounts or equivalent arrangements. Additionally, designated clearing agencies may gain access to account services at a Federal Reserve Bank, to the extent such services are not already available as the result of other laws and regulations.[637]

iii. Operational Risk

Operational risk refers to a broad category of potential losses arising from deficiencies in internal processes, personnel, and information technology. Registered clearing agencies face operational risk from both internal and external sources, including human error, system failures, security breaches, and natural or man-made disasters. Rule 17Ad-22(d)(4) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify sources of operational risk and to minimize those risks through the development of appropriate systems, controls and procedures.[638] It also requires a registered

636 See 17 CFR 240.17Ad-22(d)(3).

637 See supra Part II.B.4.f.iii (discussing the requirement under proposed Rule 17Ad-22(e)(7)(iii) for a covered clearing agency to have policies and procedures reasonably designed to ensure it has access to account services at a Federal Reserve Bank or other relevant central bank).

638 See 17 CFR 240.17Ad-22(d)(4).

clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to (i) implement systems that are reliable and secure, and have adequate, scalable capacity; and (ii) have business continuity plans that allow for timely recovery of operations and fulfillment of a clearing agency's obligations.[639]

As a result, registered clearing agencies have developed and currently maintain plans to assure the safeguarding of securities and funds, the integrity of automated data processing systems, and the recovery of securities, funds, or data under a variety of loss or destruction scenarios.[640] These plans may include turning operations over to a secondary site that is located a sufficient distance from the primary location to ensure a distinct geographic risk profile. In addition, registered clearing agencies generally maintain an internal audit department to review the adequacy of their internal controls, procedures, and records with respect to operational risks. Some registered clearing agencies also engage independent accountants to perform an annual study and evaluation of the internal controls relating to their operations.[641]

g. Access

i. Access and Participation Requirements

Rule 17Ad-22(b)(5) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide the opportunity for a person that does not perform any dealer or security-based swap

639 See id.

640 Many of these practices had been previously developed pursuant to prior Commission guidelines. See ARP I and II, supra note 324; see also supra note 326 (discussing related requirements under proposed Regulation SCI).

641 See, e.g., NSCC, Assessment of Compliance with the CPSS/IOSCO Recommendations for Central Counterparties (Nov. 2011), available at http://www.dtcc.com/legal/policy-and-compliance.aspx.

dealer services to obtain membership on fair and reasonable terms at the clearing agency to clear securities for itself or on behalf of other persons.[642] Rule 17Ad-22(b)(6) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to have membership standards that do not require participants to maintain a portfolio of any minimum size or a minimum transaction volume.[643] Rule 17Ad-22(b)(7) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide a person that maintains net capital equal or greater than $50 million with the ability to obtain membership at the clearing agency, provided such persons are able to comply with reasonable membership standards, with higher net capital requirements permissible subject to Commission approval.[644]

In addition, Rule 17Ad-22(d)(2) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, have procedures in place to monitor that participation requirements are met on an ongoing basis, and have participation requirements that are objective and publicly disclosed, and permit fair and open access.[645] Typically, a registered clearing agency's rulebook requires applicants for membership to provide certain financial and operational information prior to being admitted as a member and on an ongoing

642 See 17 CFR 240.17Ad-22(b)(5).

643 See 17 CFR 240.17Ad-22(b)(6).

644 See 17 CFR 240.17Ad-22(b)(7).

645 See 17 CFR 240.17Ad-22(d)(2).

basis as a condition of continuing membership. Registered clearing agencies review this information to ensure that the applicant has the operational capability to meet the other demands of interfacing with the clearing agency. In particular, registered clearing agencies typically require that an applicant demonstrate that it has adequate personnel capable of handling transactions with the clearing agency and adequate physical facilities, books and records, and procedures to fulfill its anticipated commitments to, and to meet the operational requirements of, the clearing agency and other members with necessary promptness and accuracy. As a result, an applicant needs to demonstrate that it has adequate personnel capable of handling transactions with the clearing agency and adequate physical facilities, books and records, and procedures to conform to conditions or requirements in these areas that the clearing agency reasonably may deem necessary for its protection. Registered clearing agencies have published these requirements on their websites.

Registered clearing agencies use an ongoing monitoring process to help them understand relevant changes in the financial condition of their members and to mitigate credit risk exposure of the clearing agency to its members. The risk management staff analyzes financial statements filed with regulators, as well as information obtained from other SROs and gathered from various financial publications, so that the clearing agency may evaluate, for instance, whether members maintain sufficient financial resources and robust operational capacity to meet their obligations as participants in the clearing agency pursuant to existing Rule 17Ad-22(d)(2)(i).

Table 1 contains membership statistics for registered clearing agencies.[646] Current membership generally reflects features of cleared markets. The decision to become a clearing member depends on the products being cleared, the structure of these asset markets as well as the

[646] See supra Part IV.B.1.

current state of regulation for cleared markets. For example, the structure of security-based swap markets and the payoffs to security-based swap contracts differs markedly from that of equity markets and common stock, which may explain some of the differences between the concentrated membership of certain clearing agencies and the relatively broader membership of others.

ii. Tiered Participation Arrangements

Tiered participation arrangements occur when clearing members (direct participants) provide access to clearing services to third parties (indirect participants). No rule under the Exchange Act currently requires a registered clearing agency through its written policies and procedures to identify, monitor, and manage material risks arising from tiered participation arrangements. The Commission understands, however, that certain registered clearing agencies have policies and procedures currently in place in order to identify, monitor, or manage such arrangements. Specifically, such clearing agencies rely on information gathered from, and distributed by, direct participants in order to manage these tiered participation arrangements. For example, under some covered clearing agencies' rules, direct participants generally have the responsibility to indicate to the clearing agency whether a transaction submitted for clearing represents a proprietary or customer position. Such rules further require direct participants to calculate, and notify the clearing agency of the value of, each customer's collateral. Direct participants also communicate with indirect participants regarding the clearing agency's margin and other requirements.

iii. Links

Rule 17Ad-22(d)(7) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to evaluate the potential sources of risks that can arise when the clearing agency establishes links either cross-border or domestically to clear or settle trades, and ensure that the risks are managed prudently on an ongoing basis.[647]

Each registered clearing agency is linked to other clearing organizations, trading platforms, and service providers. For instance, a link between U.S. and Canadian clearing agencies allows U.S. members to clear and settle valued securities transactions with participants of a Canadian securities depository. The link is designed to facilitate cross-border transactions by allowing members to use a single depository interface for U.S. and Canadian dollar transactions and eliminate the need for split inventories.[648] Registered clearing agencies that provide CCP services currently establish links to allow members to realize collateral and other operational efficiencies.

h. Efficiency

i. Efficiency and Effectiveness

Rule 17Ad-22(d)(6) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require the clearing agency to be cost-effective in meeting the requirements of participants while maintaining safe and secure operations.[649] Registered clearing agencies have procedures to control costs and to regularly review pricing levels against operating costs. These clearing agencies may use a formal budgeting process to control expenditures, and may review pricing levels against their

647 See 17 CFR 240.17Ad-22(d)(7).

648 See Exchange Act Release No. 52784 (Nov. 16, 2005), 71 FR 70902 (Nov. 23, 2005); Exchange Act Release No. 55239 (Feb. 5, 2007), 72 FR 6797 (Feb. 13, 2007).

649 See 17 CFR 240.17Ad-22(d)(6).

costs of operation during the annual budget process. Registered clearing agencies also analyze workflows in order to make recommendations to improve their operating efficiency.

ii. Communication Procedures and Standards

Although no rule under the Exchange Act expressly requires a registered clearing agency through its written policies and procedures to use or accommodate relevant internationally accepted communication procedures and standards, the Commission believes that registered clearing agencies already use these standards. Registered clearing agencies typically rely on electronic communication with market participants, including members. For example, some registered clearing agencies have rules in place stating that clearing members must retrieve instructions, notices, reports, data, and other items and information from the clearing agency through electronic data retrieval systems. Some registered clearing agencies have the ability to rely on signatures transmitted, recorded, or stored through electronic, optical, or similar means. Other clearing agencies have policies and procedures that provide for certain emergency meetings using telephonic or other electronic notice.

i. Transparency

Transparency requirements and disclosures by registered clearing agencies serve to limit the size of potential information asymmetries between registered clearing agencies, their members, and market participants. Rule 17Ad-22(d)(9) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide market participants with sufficient information for them to identify and evaluate risks and costs associated with using the clearing agency's services.[650] Information regarding the operations and services of each registered clearing agency can be viewed publicly either on the

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[650] See 17 CFR 240.17Ad-22(d)(9).

clearing agency's website or a website maintained by an affiliate of the clearing agency. Because registered clearing agencies are SROs,[651] changes to their rules are published by the Commission and are available for public viewing on each clearing agency's website.[652]

Besides providing market participants with information on the risks and costs associated with their services, registered clearing agencies regularly provide information to their members to assist them in managing their risk exposures and potential funding obligations. Some of these disclosures may be common to all members—such as information about the composition of clearing fund assets—while other disclosures that concern particular positions or obligations may only be made to individual members.

4. Determinations by the Commission

Currently, although Rule 17Ad-22(d) applies to registered clearing agencies, no mechanism exists for the Commission to make determinations with regard to covered clearing agencies of the type that would occur under proposed Rule 17Ab2-2.[653]

C. Consideration of Benefits, Costs, and the Effect on Competition, Efficiency, and Capital Formation

The discussion below sets forth the potential economic effects stemming from the proposed rules. The section begins by framing more general economic issues related to the proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2. The discussion that follows considers the effects of the proposed rules on efficiency, competition, and capital

651 See supra Part I.A and note 95 (describing the Commission's framework for regulation of SROs and the SRO rule filing process).

652 See supra note 362 (discussing requirements under Rule 19b-4(i)).

653 See proposed Rule 17Ab2-2, infra Part VII.

formation. The section ends with a discussion of the benefits and costs flowing from specific provisions of the proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2.

1. General Economic Considerations

The proposed amendments to Rule 17Ad-22, taken as a whole, would likely produce economic effects that are either conditioned on multiple provisions of proposed Rule 17Ad-22(e) being implemented as a set or are simply common to multiple provisions of the proposal. Since these economic effects are attributable in some way to each of the individual subsections of proposed Rule 17Ad-22(e), this section considers potential impacts of the proposed amendments, as a whole, through their effects on systemic risk, the discretion with which covered clearing agencies operate, market integrity, concentration in the market for clearing services and among clearing members, and QCCP status.

a. Systemic Risk

A large portion of financial activity in the United States ultimately flows through one or more registered clearing agencies that would become covered clearing agencies under the proposed rules. These clearing agencies have direct links to members and indirect links to the customers of members. They are also linked to each other through common members, operational processes, and in some cases cross-margining and cross-guaranty agreements. These linkages allow covered clearing agencies to provide opportunities for risk-sharing but also allow them to serve as potential conduits for risk transmission. Covered clearing agencies play an important role in fostering the proper functioning of financial markets. If they are not effectively managed, however, they may transmit financial shocks, particularly on days of market stress.

The centralization of clearance and settlement activities at covered clearing agencies allows market participants to reduce costs, increase operational efficiency, and manage risks more effectively.[654] While providing benefits to market participants, the concentration of these activities at a covered clearing agency implicitly exposes market participants to the risks faced by covered clearing agencies themselves, making risk management at covered clearing agencies a key element of systemic risk mitigation.

b. Discretion

The Commission recognizes that the degree of discretion permitted by the proposed rules partially determines their economic effect. Even where current practices at covered clearing agencies would not need to change significantly to comply with the proposed rules, covered clearing agencies could still potentially face costs associated with the limitations on discretion that will result from the proposed rules, including costs related to limiting a clearing agency's flexibility to respond to changing economic environments. For example, to the extent that covered clearing agencies currently in compliance with the proposed rules value the ability to periodically allow net liquid assets to drop below the minimum level specified by the proposed rules, they may incur additional costs because under the proposed rules they lose the option to do so.

Although there may be costs to limiting the degree of discretion covered clearing agencies have over risk management policies and procedures, the Commission preliminarily believes there are also potential benefits. As discussed above, clearing agencies may not fully internalize the social costs of poor internal controls and thus, given additional discretion, may not craft appropriate risk management policies and procedures. For example, even if existing regulation provides clearing agencies with the incentives necessary to manage risks appropriately in a static sense, they may not provide clearing agencies with incentives to update their risk

654 Cf. PFMI Report, supra note 1, at 9.

management programs in response to dynamic market conditions. Additionally, efforts at cost reduction or profit maximization could encourage clearing agencies to reduce the quality of risk management by, for example, choosing to update parameters and assumptions rapidly in periods of low volatility while maintaining stale parameters and assumptions in periods of high volatility. By reducing covered clearing agencies' discretion over their policies and procedures, the proposed amendments to Rule 17Ad-22 may reduce the likelihood that risk management practices lag behind changing market conditions by requiring periodic analysis of model performance while paying particular attention to periods of high volatility or low liquidity.

Subjecting covered clearing agencies to more specific requirements may have other benefits for cleared markets as well. Recent academic research has explored the ways in which regulation affects liquidity in financial markets when participants are "ambiguity averse," where ambiguity is defined as uncertainty over the set of payoff distributions for an asset.[655] Such investors may heavily weigh worst-case scenarios when they decide whether to hold the asset. The Commission preliminarily believes that regulation aimed at enhancing standards for covered clearing agencies while reducing their discretion may reduce the ambiguity associated with holding cleared assets in the presence of credit risk and settlement risk[656] and thus may allow investors to rule out worst-case states of the world. In this regard, more specific rules may

655 See e.g., Itzhak Gilboa & David Schmeidler, Maxmin Expected Utility with Non-Unique Prior, 18 J. Mathematical Econ. 141 (1989) (proposing an axiomatic foundation of a decision rule based on maximizing expected minimum payoff of a strategy).

656 Specifically, by performing key roles in the transaction process, clearing agencies serve to maintain higher minimum payoffs in poor states of the world, by, for example, immobilizing securities or adopting DVP systems.

encourage participation in cleared markets by investors that benefit from resulting risk-sharing opportunities.[657]

c. Market Integrity

The Commission preliminarily believes that the proposed amendments to Rule 17Ad-22 could provide the benefit of reduced potential for market fragmentation that may arise from different requirements across regulatory regimes. These benefits would flow to markets that are also supervised by the Board and the CFTC, and internationally, since cleared markets are global in nature and linked to one another through common participants.

Based on its consultation and coordination with other regulators, the Commission preliminarily believes its proposal is consistent and comparable, where possible and appropriate, with the rules and policy statement proposed by the Board and the rules adopted by the CFTC. The Board's proposed revisions to its PSR Policy incorporate only the headline principles contained in the PFMI Report and are consistent with the Commission's approach in proposed Rule 17Ad-22(e).[658]

With respect to the rules proposed by the Board and adopted by the CFTC, in many instances the rules proposed by the Commission are consistent with these regulatory provisions, as each of the three rule sets are intended to be consistent with the headline principles contained

657 See e.g., David Easley & Maureen O'Hara, Microstructure and Ambiguity, 65 J. Fin. 1817 (2010) (using a theoretical model of trade on venues that differ in rules, the authors show how rules that reduce market-related ambiguity may induce a participatory equilibrium).

658 The Commission preliminarily notes that the Commission's proposal provides a greater level detail than the proposed PSR Policy and is tailored to take into account considerations particular to covered clearing agencies, consistent with the Commission's role as the supervisory agency under the Clearing Supervision Act. The Commission further notes that, in contrast to the Board's PSR Policy, proposed Rule 17Ad-22(e) would constitute an enforceable federal regulation if adopted. See proposed PSR Policy, supra note 53, at 2841 (distinguishing the legal effect of proposed Reg. HH from the proposed PSR Policy).

in the PFMI Report,[659] but the Commission's proposals differ from those requirements proposed by the Board and adopted by the CFTC in terms of the specific portions of the key considerations and explanatory text contained in the PFMI Report that are, or are not, referenced or emphasized. In some cases, the Commission is proposing more specific requirements than those proposed by the Board or adopted the CFTC, and, in others, it is proposing rules with fewer additional specific requirements.

The following discussion provides examples of proposed rule provisions that are representative of the differences between the Commission's proposal and the Board's proposal and the CFTC's final rules, where the Commission is proposing more detailed requirements than those proposed by the Board or adopted by the CFTC:

- In proposing Rule 17Ad-22(e)(4), the Commission would explicitly permit a covered clearing agency's policies and procedures to be reasonably designed to maintain financial resources either in combined or separately maintained clearing or default funds. Rules proposed by the Board and adopted by the CFTC do not include a comparable provision. The Commission preliminarily believes this requirement is appropriate because

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659 For example, the Commission preliminarily believes that proposed Rule 17Ad-22(e)(23), requiring disclosure of rules, key procedures, and market data, contains the same substantive requirements as rules proposed by the Board and adopted by the CFTC. See proposed Reg. HH, supra note 53, at 3686–88, 3693 (the Board proposing Sec. 234.3(a)(23)); DCO Int'l Standards Release, supra note 53, at 72493–94, 72521 (CFTC adopting Sec. 39.37).

In this case, the Commission notes that regulators have taken slightly different approaches to achieving disclosure of rules, key procedures, and market data. The CFTC requires disclosure through the CPSS-IOSCO Disclosure Framework. See DCO Int'l Standards Release, supra note 53, at 72493–94, 72521 (CFTC adopting Sec. 39.37(a)); see also CPSS-IOSCO, Disclosure Framework for Financial Market Infrastructures (Apr. 2012), available at http://www.bis.org/publ/cpss101c.pdf. The Commission and the Board have proposed to require disclosure through a comprehensive public disclosure set forth in their proposed rules. The Commission preliminarily believes, however, that the three disclosure regimes impose the same substantive requirements.

permitting a covered clearing agency to maintain a separate default fund for purposes of complying with proposed Rules 17Ad-22(e)(4)(ii) and (iii) increases the range of options available to covered clearing agencies when complying with this requirement and, when used appropriately, will allow a covered clearing agency to distribute the costs and responsibilities of clearing membership more equitably among clearing members.

- In proposing Rule 17Ad-22(e)(7), the Commission would permit a covered clearing agency's policies and procedures to include as qualifying liquid resources (i) assets that are readily available and convertible into cash through prearranged funding arrangements determined to be highly reliable even in extreme but plausible market conditions by the board of directors of the covered clearing agency, following a review conducted for this purpose not less than annually, and (ii) other assets that are readily available and eligible for pledging to a relevant central bank, if the covered clearing agency has access to routine credit at such central bank that permits said pledges or other transactions by the covered clearing agency. Rules proposed by the Board do not include a provision comparable to either of these two proposed requirements, and rules adopted by the CFTC do not include a provision including as qualifying liquid resources assets readily available and eligible for pledging to a central bank.[660]

The Commission preliminarily believes this requirement is appropriate given the specific circumstances of the U.S. securities markets. U.S. securities markets are among the largest and most liquid in the world, and CCPs operating in the United States are also among the largest in the world. The resulting peak liquidity demands of CCPs are

[660] See proposed Reg. HH, supra note 53, at 3677–78, 3691 (the Board proposing Sec. 234.3(a)(7)); DCO Int'l Standards Release, supra note 53, at 72487–91, 72518 (CFTC adopting Sec. 39.33(c)).

therefore proportionately large on both an individual and an aggregate basis, and the ability of CCPs to satisfy a requirement limiting qualifying liquid resources to committed facilities could be constrained by the capacity of traditional liquidity sources in the U.S. banking sector in certain circumstances. The Commission preliminarily believes that limiting the funding arrangements that are included within the definition of qualifying liquid resources to committed funding arrangements is not appropriate in the case of the U.S. securities markets and expanding the concept of qualifying liquid resources to include other highly reliable funding arrangements is necessary and appropriate to ensure the proper functioning of covered clearing agencies under the Exchange Act. For similar reasons, the Commission preliminarily believes it is appropriate to include in the definition of qualifying liquid resources assets that a central bank would permit a covered clearing agency to use as collateral, to the extent such covered clearing agency has access to routine credit at such central bank.

- In proposing Rule 17Ad-22(e)(13), the Commission would explicitly require a covered clearing agency's policies and procedures to be reasonably designed to ensure that the covered clearing agency has the authority and operational capacity to contain losses and liquidity demands in a timely manner and to continue to meet its obligations by, among other things, addressing the allocation of credit losses the covered clearing agency may face. Rules proposed by the Board and adopted by the CFTC do not include a comparable provision to address the allocation of credit losses.[661] The Commission preliminarily believes this requirement is appropriate to help ensure that credit losses a

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661 See 17 CFR 39.16; proposed Reg. HH, supra note 53, at 3680–81, 3692 (the Board proposing Sec. 234.3(a)(13)); see also DCO Principles Release, supra note 53, at 69395–97, 69442 (CFTC adopting Sec. 39.16).

covered clearing agency may reasonably be expected to experience are capable of allocation through pre-established practices of the covered clearing agency. The proposed rule would also facilitate the orderly handling of member defaults and provide certainty and transparency by enabling members to understand their obligations to the covered clearing agency in extreme circumstances ex ante.

- In proposing Rule 17Ad-22(e)(18), the Commission would explicitly require a covered clearing agency's policies and procedures to be reasonably designed to require monitoring of compliance with access and participation requirements. Rules proposed by the Board and adopted by the CFTC do not include a comparable provision. The Commission preliminarily believes this requirement is consistent with Exchange Act provisions requiring registered clearing agencies to have rules designed to not permit unfair discrimination in the admission of participants because it helps ensure that a covered clearing agency complies with its own membership requirements.
- In proposing Rule 17Ad-22(e)(19), the Commission would explicitly require a covered clearing agency's policies and procedures to be reasonably designed to require regular review of its tiered participation arrangements. Rules proposed by the Board and adopted by the CFTC do not include a comparable provision. The Commission preliminarily believes this requirement is consistent with Exchange Act provisions requiring registered clearing agencies to have rules designed to not permit unfair discrimination in the admission of participants because it helps ensure that a covered clearing agency periodically reconsiders whether in practice its membership requirements may result in either an inappropriately broad or narrow membership.

The following discussion provides examples of proposed rule provisions that are representative of the differences between the Commission's proposal and the Board's proposal and the CFTC's final rules, where the Commission is proposing requirements that are more general than those proposed by the Board or adopted by the CFTC:

- In proposing Rule 17Ad-22(e)(2), the Commission would not require a covered clearing agency's policies and procedures to be reasonably designed to include requirements for disclosure of board decisions, review of the performance of the board of directors and individual directors, documentation and disclosure of governance arrangements, procedures for managing conflicts of interests involving board members, and oversight of the risk function. Rules adopted by the CFTC include such requirements.[662] The Commission preliminarily believes that such requirements would in part be duplicative of existing Exchange Act requirements applicable to covered clearing agencies grounded in the broad definition of the term "rules of a clearing agency" in Section 3(a)(27) of the Exchange Act,[663] and otherwise have been contemplated by the Commission's proposed Regulation MC.[664] Accordingly any further requirements in this respect would be considered by the Commission separately.
- In proposing Rules 17Ad-22(e)(4) and (e)(7), the Commission would not require a covered clearing agency's policies and procedures for stress testing its financial resources

[662] See DCO Int'l Standards Release, supra note 53, at 72480–81, 72515 (CFTC adopting Sec. 39.30).

[663] See 15 U.S.C. 78c(a)(27).

[664] See supra note 111 (discussing rules for governance arrangements proposed by the Commission to, among other things, mitigate conflicts of interest at registered clearing agencies that provide CCP services for security-based swaps).

and liquid resources, respectively, to cover specific stress scenarios, as rules adopted by the CFTC do.[665] The Commission preliminarily believes it is appropriate to provide discretion to the covered clearing agencies to identify the stress scenarios most appropriate for their needs given their status as SROs subject to the Commission's oversight, and to rely upon other tools available to the Commission through its supervisory and examination programs to ensure the responsibilities of covered clearing agencies in this regard are fulfilled.

- In proposing Rule 17Ad-22(e)(5), the Commission would not specifically require, as the CFTC does in its rules, a covered clearing agency's policies and procedures to be reasonably designed to (i) establish prudent valuation practices and develop haircuts that are tested regularly and take into account stressed market conditions (including to reduce the need for procyclical adjustments); (ii) avoid concentrated holdings of certain assets where it could significantly impair the ability to liquidate such assets quickly without significant adverse price effects; and (iii) use a collateral management system that is well designed and operationally flexible, such that it, among other things, accommodates changes in the ongoing monitoring and management of collateral; and (iv) allow for the timely valuation of collateral and execution of any collateral or margin calls.[666] While the Commission preliminarily agrees that these requirements may facilitate prudent practices, the Commission preliminarily observes that consideration of these practices would fall within the general responsibilities of a covered clearing agency and its board

665 See DCO Int'l Standards Release, supra note 53, at 72492–93, 72520 (CFTC adopting Sec. 39.36(c)).

666 See 17 CFR 39.11, 39.13; see also DCO Principles Release, supra note 53 (CFTC adopting Secs. 39.11 and 39.13).

of directors. The Commission therefore preliminarily believes that proposed Rule 17Ad-22(e)(5) strikes the appropriate balance in establishing policies and procedures requirements with respect to collateral management.

- In proposing Rule 17Ad-22(e)(6), the Commission also would not require a covered clearing agency's policies and procedures to be reasonably designed to determine the appropriate historic time period for the margin methodology based on the characteristics of each product, spread, account, or portfolio or to require specifying minimum liquidation periods for different types of derivatives. Rules adopted by the CFTC include such requirements.[667] While the Commission preliminarily agrees that these requirements may facilitate prudent practices, the Commission preliminarily observes that consideration of these practices would fall within the general responsibilities of a covered clearing agency and its board of directors. The Commission therefore preliminarily believes that proposed Rule 17Ad-22(e)(6) strikes the appropriate balance in establishing policies and procedures requirements with respect to risk management.

These differences between the Commission's proposal and the Board's proposed rules and the CFTC's final rules are provided here as examples of the differences observed between the respective rule sets and do not constitute an exhaustive list. In preliminarily formulating the specific requirements of the proposed rules in furtherance of Section 17A of the Exchange Act, the Commission was guided by its experience in supervising registered clearing agencies, including through the SRO rule filing process under Section 19(b) of the Exchange Act and Rule 19b-4, periodic inspections and examinations, and other monitoring of the activities of registered

[667] See 17 CFR 39.13(g)(2); see also DCO Principles Release, supra note 53, at 69364–79, 69438 (CFTC adopting Sec. 39.13(g)(2)).

clearing agencies.[668] The Commission also took into account the particular circumstances of the U.S. securities markets, including but not limited to business models of and current practices at covered clearing agencies, characteristics of the products cleared, the nature of the covered clearing agencies' participant base, and other factors. The Commission preliminarily believes the differences between its proposal and the Board's proposed rules and the CFTC's final rules are appropriate for the reasons noted above. The Commission further preliminarily notes that some of the differences between the Commission's proposal and the CFTC's final rules is attributable to differences between the scope of the Commission's and the CFTC's regulatory authority.[669]

Further, CPSS-IOSCO members are also in various stages of implementing the standards set forth in the PFMI Report into their own regulatory regimes, and the Commission preliminarily believes that proposing a set of requirements generally consistent with the relevant international standards would result in diminished likelihood that participants in cleared markets would restructure and operate in less-regulated markets.[670] Additionally, international standards such as the Basel III framework could create complications for U.S. clearing agencies not subject to regulations based on the standards set in the PFMI Report as a result of the Basel III framework's treatment of QCCPs. In particular, if U.S. clearing agencies do not obtain QCCP

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668 See supra Part I.A and note 96 (describing the Commission's framework for regulation of SROs and the SRO rule filing process).

669 For example, the Commission is proposing Rules 17Ad-22(e)(11) and (12) to establish requirements for covered clearing agencies that provide CSD services and for exchange-of-value settlement systems. See supra Parts II.B.8–9 and infra Part VII (discussing the proposed rules and providing rule text, respectively). The CFTC has not proposed comparable rules because CSDs and securities settlement systems do not fall within the scope of its regulatory authority.

670 See supra note 53 (citing the Board's proposal and the CFTC's final rules).

status from foreign banking regulators who have adopted rules conforming to the Basel III framework because, for instance, the regulatory framework is not consistent with the standards set forth in the PFMI Report, foreign bank members of U.S. clearing agencies may have incentives to move their clearing business to clearing agencies in jurisdictions where they might obtain lower capital requirements under the Basel III framework.[671]

Failure to maintain consistency with other regulators may disrupt cleared markets in a number of ways. Significant differences across regulatory regimes may encourage participants to restructure their operations in order to avoid a particular regulatory regime.[672] Such differences may reduce the liquidity of cleared products in certain markets if they result in an undersupply of clearing services. Further, inconsistency in regulation across jurisdictions may increase the likelihood that restructuring by market participants in response such inconsistency results in concentrating clearing activity in regimes with a weaker commitment to policies and procedures for sound risk management.

In the case of clearing agency standards, there are additional motivations for consistency with other regulatory requirements. The Commission preliminarily believes that such consistency would prevent the application of inconsistent regulatory burdens and thereby reduce the likelihood that participants in cleared markets would restructure and operate in less-regulated

671 See supra note 48 and infra Part IV.C.1.e (discussing the Basel III capital requirements and the economic effect of QCCP status under the Basel III capital requirements, respectively).

672 See, e.g., Arnoud W.A. Boot, Silva Dezõelan, & Todd T. Milbourn, Regulatory Distortions in a Competitive Financial Services Industry, 16 J. Fin. Serv. Res. 249 (2000) (showing that, in a simple industrial organization model of bank lending, a change in the cost of capital resulting from regulation results in a greater loss of profits when regulated banks face competition from non-regulated banks than when regulations apply equally to all competitors); Victor Fleischer, Regulatory Arbitrage, 89 Tex. L. Rev. 227 (2010) (discussing how, when certain firms are able to choose their regulatory structure, regulatory costs are shifted onto those entities that cannot engage in regulatory arbitrage).

markets. Additionally, such consistency would allow foreign bank clearing members and foreign bank customers of clearing members of covered clearing agencies to be subject to lower capital requirements under the Basel III framework.[673]

d. Concentration

The economic effects associated with the proposed rules may also be partially determined by the economic characteristics of clearing agencies. Generally, the economic characteristics of FMIs, including clearing agencies, include specialization, economies of scale, barriers to entry, and a limited number of competitors.[674] Such characteristics, coupled with the particulars of an FMI's legal mandate, could result in market power, leading to lower levels of service, higher prices, and under-investment in risk management systems.[675]

The centralization of clearing activities in a relatively small number of clearing agencies somewhat insulated from market forces may result in a reduction in their incentives to innovate and to invest in the development of appropriate risk management practices on an ongoing basis, particularly when combined with the cost reduction pressures noted above in Part IV.A.[676] However, the Commission notes that the inverse may not necessarily hold. In other words, additional competition in the market for clearing services may not necessarily result in improved risk management. For instance, aggressive price-cutting in a "race to the bottom" may result in clearing agencies accepting lower-quality collateral, requiring lower margin and default fund

673 See Basel III capital requirements, supra note 48.

674 See supra note 49 (defining "financial market infrastructure").

675 Cf. PFMI Report, supra note 1, at 11.

676 Kenneth J. Arrow, Economic Welfare and the Allocation of Resources for Invention 609–626, in The Rate and Direction of Inventive Activity: Economic and Social Factors (NBER, 1962), available at http://www.nber.org/chapters/c2144.pdf.

contributions, lowering access requirements, or holding lower reserves, potentially undermining their risk management efforts.[677]

Market power may raise particular issues with respect to the allocation of benefits and costs flowing from these proposed rules and precipitate changes in the structure of the financial networks that are served by covered clearing agencies. For example, as a result of limited competition,[678] existing covered clearing agencies may easily pass the incremental costs associated with enhanced standards on to their members, who may share these costs with their customers, potentially resulting in increased transaction costs in cleared securities.

If incremental increases in costs lead clearing agencies to charge higher prices for their services, then certain clearing members may choose to terminate membership and cease to clear transactions for their customers. Should this occur the result may be further concentration

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677 See CPSS, Market Structure Development in the Clearing Industry: Implications for Financial Stability, at sec. 5 (Nov. 2010), available at http:/www.bis.org/publ/cpss92.pdf; see also Siyi Zhu, Is There a 'Race to the Bottom' in Central Counterparties Competition? – Evidence from LCH.Clearnet SA, EMCF and EuroCCP, DNB Occasional Studies, Vol. 9, No. 6 (2011); John Kiff et al., Credit Derivatives: Systemic Risks and Policy Options (IMF Working Paper No. 254, Nov. 2009), available at http://www.imf.org/external/pubs/ft/wp/2009/wp09254.pdf.

678 See generally Nadia Linciano, Giovanni Siciliano & Gianfranco Trovatore, The Clearing and Settlement Industry: Structure Competition and Regulatory Issues (Italian Secs. & Exch. Comm'n Research Paper 58, May 2005), available at http://www.ssrn.com/abstract=777508 (concluding in part that the core services offered by the clearance and settlement industry tend toward natural monopolies because the industry can be characterized as a network industry, where consumers buy systems rather than single goods, consumption externalities exist, costs lock-in consumers once they choose a system, and production improves with economies of scale); Heiko Schmiedel, Markku Malkamäki & Juha Tarkka, Economies of Scale and Technological Development in Securities Depository and Settlement Systems, at 10 (Bank of Fin. Discussion Paper 26, Oct. 2002), available at http://www.suomenpankki.fi/en/julkaisut/tutkimukset/keskustelualoitteet/Documents/0226.pdf ("The overall results of this study reveal the existence of substantial economies of scale among depository and settlement institutions. On average, the centralized U.S. system is found to be the most cost effective settlement system and may act as the cost saving benchmark.").

among clearing members, where each remaining member clears a higher volume of transactions. In this case, clearing agencies and the financial markets they serve would be more exposed to these larger clearing members. These remaining clearing members may, however, each internalize more of the costs their activity in cleared markets imposes on the financial system.

The increased importance of a small set of clearing members, in turn, may result in firms not previously systemically important increasing in systemic importance. This is particularly true for clearing members that participate in multiple markets, both cleared and not cleared.[679] However, adequate regulation of capital levels and margin amounts at surviving clearing members could mean that, though shocks to these members may be larger, the propagation of shocks may be limited to a smaller set of entities and their equity holders.

e. Qualifying CCP Status and Externalities on Clearing Members

An effect of the proposed amendments to Rule 17Ad-22 is that covered clearing agencies required to comply with the proposed rules may be more likely to qualify as QCCPs in non-U.S. jurisdictions that have adopted the Basel III framework's QCCP definition. Under the Basel III framework, a QCCP is defined as an entity operating as a CCP that is prudentially supervised in a jurisdiction where the relevant regulator has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the standards set forth in the PFMI Report.[680] Because the proposed amendments to Rule 17Ad-22 are intended to be in line with the standards set forth in the PFMI Report, the Commission preliminarily believes that foreign bank clearing members of certain covered clearing agencies

[679] See, e.g., Roe, supra note 172 (arguing that counterparty risk concentrated within CCPs may be transferred to the broader financial system through links between clearing members and their clients).

[680] See supra note 48 (discussing the Basel III capital requirements).

and foreign banks clearing indirectly through clearing members of covered clearing agencies may benefit from covered clearing agencies obtaining QCCP status. In particular, bank clearing members and bank indirect participants of covered clearing agencies that could attain QCCP status would face lower capital requirements with respect to cleared derivatives and repurchase agreement transactions because, under the Basel III framework, capital requirements for bank exposures to QCCPs are lower than capital requirements for bank exposures to non-qualifying CCPs for these products. Although the Board and the Office of the Comptroller of the Currency have already adopted rules implementing the Basel III capital requirements that would identify all covered clearing agencies (with the exception of ICEEU) as QCCPs for the purposes of applying risk weights to assets at U.S. banks,[681] the proposed amendments to Rule 17Ad-22 may result in non-U.S. bank clearing members experiencing lower capital requirements related to exposures against covered clearing agencies relative to a baseline scenario in which foreign banking regulators do not determine that a covered clearing agency is a QCCP.[682]

The Basel III framework affects capital requirements for bank exposures to central counterparties in two important ways. The first relates to trade exposures, defined under the Basel III capital requirements as the current and potential future exposure of a clearing member or indirect participant in a CCP arising from OTC derivatives, exchange-traded derivatives transactions, and securities financing transactions. If these exposures are held against a QCCP, they will be assigned a risk weight of 2%. In contrast, exposures against non-qualifying CCPs do not receive lower capital requirements relative to bilateral exposures and are assigned risk

681 See infra Part IV.C.1.e.

682 The Commission notes that benefits to banks that may arise as a result of the proposed rules may be contingent upon regulators in other jurisdictions taking action to recognize the QCCP status of covered clearing agencies.

weights between 20% and 100%, depending on counterparty credit risk. Second, the Basel III capital requirements impose a cap on risk weights applied to default fund contributions, limiting risk-weighted assets (subject to a 1250% risk weight) to a cap of 20% of a clearing member's trade exposures against a QCCP. This is in contrast to treatment of exposures against non-qualifying CCPs, which are uncapped and subject to a 1250% risk weight. Because QCCP status generally impacts capital treatment, any benefits of attaining QCCP status will likely accrue, at least in part, to foreign clearing members or foreign indirect participants subject to the Basel III capital requirements.[683] As a result of lower risk weights applied to exposures and a cap on capital requirements against default fund obligations, clearing members of QCCPs subject to Basel III capital requirements may experience an improved capital position relative to bank members of non-QCCPs. This may lower the costs of debt capital for bank members of QCCPs.[684]

Non-U.S. banks that are constrained by Basel III tier one capital requirements would face a shock to risk-weighted assets once capital rules come into force.[685] The size of the shock depends on regulators' determinations with regard to QCCP status. Regardless of the size of the shock and in order to come into compliance with capital rules, however, affected banks will have

683 For a discussion of the effects of QCCP status on competition between bank and non-bank clearing members, see Part IV.C.2.a.

684 See supra note 593 (noting that the Commission currently expects the lower capital treatment under the Basel III framework to affect registered clearing agencies FICC, ICEEU, and OCC, each of which would meet the definition of a "covered clearing agency" under the proposed rules).

685 As discussed above, the Board and Office of Comptroller of the Currency have adopted rules implementing capital requirements under Basel III that make capital treatment for exposures to CCPs independent of the proposed rules for U.S. banks regulated by these two agencies, and therefore the Commission preliminarily believes no benefits would accrue to U.S. bank clearing members of FICC and OCC.

to raise capital or reduce leverage. In the absence of perfect markets, these banks may incur ongoing costs as a result.

In quantifying the benefits of achieving QCCP status, the Commission based its estimate on publicly available information with regard to OCC.[686] To estimate the upper bound for the potential benefits accruing to bank clearing members at OCC as a result of QCCP status, the Commission identified a sample of 20 bank clearing members at OCC and, for each bank, collected information about total assets, risk weighted assets, net income and tier one capital ratio at the holding company level for 2012.[687] The Commission then allocated trade exposures and default fund exposures across the sample of bank clearing members based on the level of risk-weighted assets.[688] The Commission measured the impact on risk-weighted assets for non-

[686] Under the Basel III framework ICCEU and FICC's repurchase agreement segment would also be eligible for QCCP status. However, FICC does not report counterparties to repo agreements, and ICEEU does not separately report exposures related to security-based swap clearing, so we are currently unable to quantify potential benefits related to QCCP status for these entities.

[687] The Commission used the set of entities it identified as banks on OCC's member list, available at http://www.optionsclearing.com/membership/member-information/. For U.S. bank holding companies, 2012 total assets, risk weighted assets, net income, and tier 1 capital ratios were collected from Y-9C reports available at the National Information Center, http://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx. For non-U.S. bank holding companies, Commission staff obtained corresponding data from financial statements and supplementary financial materials posted to bank websites. Where necessary, values were converted back to U.S. dollars at appropriate exchange rates obtained from Thomson Reuters Datastream and the Federal Reserve, http://www.federalreserve.gov/releases/h10/hist/.

[688] For example, one bank in the sample, with 6.25% of total risk-weighted assets, was assigned 6.25% of the total trade and default fund exposures while another bank in the sample, with 3.43% of total risk weighted assets, was assigned 3.43% of these exposures. Because trade exposures of OCC members against OCC are nonpublic, the Commission used the balance of OCC margin deposits and deposits in lieu of margin held at OCC, \$57.48 billion, as a proxy for trade exposures. OCC's 2012 clearing fund deposits were valued at \$2.66 billion. See OCC, 2012 Annual Report, available at http://www.optionsclearing.com/components/docs/about/annual-reports/occ_2012_annual_report.pdf.

U.S. bank clearing members under two different capital treatment regimes. The first regime is in the absence of QCCP status, assuming a 100% risk weight applied to trade exposures and 1250% risk-weight applied to default fund exposures for non-U.S. members. In the second regime, OCC obtains QCCP status, and banks are allowed to apply a 2% risk weight applied to trade exposures and a 1250% risk weight to default fund exposures up to a total exposure cap of 20% of trade exposures.[689] If OCC is determined to be a QCCP, then the increase in risk weighted assets will be smaller in magnitude, implying a smaller adjustment at lower cost. The Commission preliminarily estimates that benefits associated with OCC obtaining QCCP status stemming from lower capital requirements against trade exposures to QCCPs as a result of the proposed rules to have an upper bound of $600 million per year, or approximately 0.60% of the total 2012 net income reported by bank clearing members at OCC.

The Commission's analysis is limited in several respects and relies on several assumptions. First, a limitation of our proxy for trade exposures and our use of OCC's clearing fund is that the account balances include deposits by bank clearing members, who would experience lower capital requirements under the Basel III framework, and non-bank clearing members who would not. The Commission preliminarily assumes, for the purposes of establishing an upper bound for the benefits to market participants that are associated with QCCP status for OCC under the proposed rules, that the balance of both OCC's margin account and OCC's default fund are attributable only to bank clearing members. Additionally, we assume an

[689] The Basel III framework allows banks to compute default fund exposures in two ways. Method 1 involves computing capital requirements for each member proportional to its share of an aggregate capital requirement for all clearing members in a scenario where to average clearing members default. The Commission currently lacks data necessary to compute default fund exposures under this approach, instead we use Method 2, which caps overall exposure to a QCCP at 20% of trade exposures. See Basel III framework, supra note 48, Annex 4, paras. 121–25 (outlining two methods for computing default fund exposures).

extreme case where, in the absence of QCCP status, trade exposures against a CCP would be assigned a 100% risk weight, causing the largest possible shock to risk-weighted assets for affected banks.

Concluding that lower capital requirements on trade exposures to OCC would produce effects in the real economy also requires that certain conditions exist. Agency problems, taxes, or other capital market imperfections could result in banks targeting a particular capital structure. Further, capital constraints on bank clearing members subject to the Basel III framework should bind so that higher capital requirements on bank clearing members subject to the Basel III framework in the absence of QCCP status would cause these banks to exceed capital constraints if they chose to redistribute capital to shareholders or invest capital in projects with returns that exceed their cost of capital. Using publically available data, however, it is not currently possible to determine whether capital constraints will bind for bank clearing members when rules applying Basel III capital requirements come into force, so to estimate an upper bound for the effects of QCCP status on bank clearing members we assume that tier one capital constraints for all bank clearing members of OCC would bind in an environment with zero weight placed on bank exposures to CCPs.[690]

For the purposes of quantifying potential benefits from QCCP status, the Commission has also assumed that banks choose to adjust to new capital requirements by deleveraging. In

690 The Commission notes that, at present, no bank in its sample of bank clearing members of OCC is bound by capital requirements under the Basel III framework. Bank holding company risk-weighted assets, adjusted total assets, and capital ratio data have been taken from http://www2.fdic.gov/SDI/. The Commission used data from 2009–2012 for its sample of bank clearing members and assumed no bank-specific countercyclical capital buffers for these banks. This suggests a minimum tier 1 capital ratio of 9.6%, exceeding the Basel III minimum by 1.1%. The same analysis suggests a minimum total capital ratio of 12.3%, exceeding the Basel III minimum by 1.8%.

particular, the Commission assumed that banks would respond by reducing risk-weighted assets equally across all risk classes until they reach the minimum tier one capital ratio under the Basel framework of 8.5%. We measure the ongoing costs to each non-U.S. bank by multiplying the implied change in total assets by each bank's return on assets, estimated using up to 12 years of annual financial statement data.[691]

The Basel III capital requirements for exposures to CCPs yield additional benefits for QCCPs that the Commission is currently unable to quantify due to lack of data concerning client clearing arrangements by banks. For client exposures to clearing members, the Basel III capital requirements allow participants to reflect the shorter close-out period of cleared transactions in their capitalized exposures. The Basel III framework's treatment of exposures to CCPs also applies to client exposures to CCPs through clearing members. This may increase the likelihood that bank clients of bank clearing members that are subject to the Basel III capital requirements share some of the benefits of QCCP status.

Furthermore, the fact that the Basel III capital requirements apply to bank clearing members may have important implications for competition and concentration. While the proposed rules may extend lower capital requirements against exposures to CCPs to non-U.S. bank clearing members of covered clearing agencies,[692] the benefits of QCCP status will still be limited to bank clearing members. However, the costs associated with compliance with the proposed rules may be borne by all clearing members, regardless of whether or not they are

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691 This data has been taken from Compustat. Due to data limitations, for certain banks a shorter window was used for this calculation. The minimum sample window was nine years.

692 See supra note 599 and accompanying text (noting that banks supervised by the Board and the Office of the Comptroller of the Currency would treat covered clearing agencies as QCCPs for the purposes of calculating regulatory capital ratios).

supervised as banks. A potential consequence of this allocation of costs and benefits may be "crowding out" of members of QCCPs that are not banks and will not experience benefits with respect to the Basel III framework. This may result in an unintended consequence of increased concentration of clearing activity among bank clearing members. As noted in Part IV.C.1.d, this increased concentration could mean that each remaining clearing member becomes more important from the standpoint of systemic risk transmission.

In addition to benefits for bank clearing members, certain benefits resulting from QCCP status may also accrue to covered clearing agencies. If banks value lower capital requirements attributable to QCCP status, bank clearing members may prefer membership at QCCPs to membership at CCPs that are not QCCPs. A flight of clearing members from covered clearing agencies in the absence of QCCP status would result in default-related losses being mutualized across a narrower member base. If the flight from covered clearing agencies results in lower transactional volume at these clearing agencies, then economies of scale may be lost, resulting in higher clearing fees and higher transaction costs in cleared products.

2. Effect on Competition, Efficiency, and Capital Formation

The proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2 have the potential to affect competition, efficiency, and capital formation. As with the rest of the benefits and costs associated with the proposed amendments to Rule 17Ad-22, the Commission preliminarily believes that several of the effects described below only occur to the extent that covered clearing agencies do not already have operations and governance mechanisms that conform to the requirements in proposed Rule 17Ad-22(e). Additionally, the Commission preliminarily believes that consistency with international regulatory frameworks, as embodied by the standards set forth in the PFMI Report, which may promote the integrity of cleared markets, could have substantial effects on competition, efficiency, and capital formation.

a. Competition

Two important characteristics of the market for clearance and settlement services are high fixed costs and economies of scale. Large investments in risk management and information technology infrastructure costs, such as financial data database and network maintenance expenses, are components of high fixed costs for clearing agencies. Consequently, the clearance and settlement industry exhibits economies of scale in that the average total cost per transaction, which includes fixed costs, diminishes with the increase in transaction volume as high fixed costs are spread over a larger number of transactions.

Furthermore, high fixed costs translate into barriers to entry that preclude competition. Lower competition is an important source of market power for clearing agencies. As a result, clearing agencies possess the ability to exert market power and influence the fees charged for clearance and settlement services in the markets they serve.[693] Any costs resulting from the proposed amendments may have the effect of raising already high barriers to entry. As the potential entry of new clearing agencies becomes more remote, existing clearing agencies may be able to reduce service quality, restrict the supply of services, or increase fees above marginal cost in an effort to earn economic rents from participants in cleared markets.[694]

Even if they could not take advantage of a marginal increase in market power, clearing agencies may use their market power to pass any increases in costs that flow from the proposed amendments to their members. This may be especially true in the cases of member-owned clearing agencies, such as DTC, FICC, NSCC, and OCC, where members lack the opportunity to pass costs through to outside equity holders. Allowing clearing members to serve on the board

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693 See, e.g., Clearing Agency Standards Release, supra note 5, at 66263.

694 See, e.g., Clearing Agency Standards Release, supra note 5, at 66263 n.481.

of directors of a covered clearing agency may align a covered clearing agency's incentives with its membership. Certain complications may also arise, however, when clearing members sit on boards of covered clearing agencies as members of the board and may choose to allocate the costs of enhanced risk management inefficiently across potential competitors, in an effort to reduce their own share of these costs.

Members who are forced to internalize the costs of additional requirements under the proposed rules may seek to terminate their membership. Additionally, prospective clearing members may find it difficult to join clearing agencies, given the additional costs they must internalize.[695] Remaining clearing members may gain market power as a result, enabling them to extract economic rents from their customers. Rent extraction could take the form of higher transaction costs in cleared markets, thereby reducing efficiency, as discussed below.

The Commission also acknowledges that proposed Rule 17Ad-22(e)(19) may affect competition among firms that choose to become clearing members, and those who provide clearing services indirectly, through a clearing member. Monitoring and managing the risks associated with indirect participation in clearing may be costly. If monitoring and managing the risks associated with indirect participation in clearing proves costly for clearing agencies and if clearing agencies are able to pass the additional costs related to monitoring and managing risks to clearing members, it may cause marginal clearing members unable to absorb these additional costs to exit. While these exits may be socially efficient, since they reflect the internalization of costs otherwise imposed upon other participants in cleared markets through increased probability of clearing agency default, they may nevertheless result in lower competition among clearing

[695] See supra Part IV.C.1.d (discussing concentration both in the market for clearing services and among clearing members).

members for market share, potentially providing additional market power to the clearing members that remain.

The Commission preliminarily believes, however, that management of risks from indirect participation is important in mitigating the risks that clearing agencies pose to financial stability. The tiered participation risk exposures, including credit, liquidity, and operational risks inherent in indirect participation arrangements, may present risks to clearing agencies, their members, and to the broader financial markets. For instance, if the size of an indirect participant's positions is large relative to a clearing member's capacity to absorb risks, this may increase the clearing member's default risk. Consequently, a clearing agency with indirect participation arrangements may be exposed to the credit risk of an indirect participant through its clearing members. Similarly, a margin call on, or a default by, an indirect participant could constrain liquidity of its associated clearing members, making it more difficult for these members to manage their positions at the clearing agency.

The consistency across regulatory frameworks contemplated by the proposed rules may also affect competition. Financial markets in cleared products are global, encompassing many countries and regulatory jurisdictions. Consistency with international regulatory frameworks may facilitate entry of clearing agencies into new markets. By contrast, conflicting or duplicative regulation across jurisdictions, or even within jurisdictions, may cause competitive friction that inhibits entry and helps clearing agencies behave like local monopolists. Consistency in regulation can facilitate competition among clearing agencies so long as regulation is not so costly as to discourage participation in any market. Additionally, the Commission preliminarily believes that proposed Rule 17Ad-22(e)(23) may facilitate competition among clearing agencies across jurisdictions by requiring public disclosures that enable market participants to compare clearing agencies more easily.

The consistency across regulatory requirements contemplated by the proposed rules may affect competition among banks in particular. Clearing derivative and repurchase agreement transactions through QCCPs will result in lower capital requirements for banks under the Basel III capital requirements. Therefore, consistency with the standards set forth in the PFMI Report may allow banks that clear these products through covered clearing agencies to compete on equal terms with banks that clear through other clearing agencies accorded QCCP status. This effect potentially countervails higher barriers to entry that enhanced risk management standards may impose on clearing members by lowering the marginal cost of clearing these transactions. Furthermore, covered clearing agencies potentially compete with one another for volume from clearing members. Since clearing members receive better treatment for exposures against QCCPs, clearing members will find it less costly to deal with QCCPs. Failure to establish requirements consistent with the standards set forth in the PFMI Report may place U.S. covered clearing agencies at a competitive disadvantage globally.

The ability of covered clearing agencies to obtain QCCP status may also affect competition among clearing agencies. Under the Basel III framework, QCCP status would have practical relevance only for covered clearing agencies providing CCP services for derivatives, security-based swaps, and securities financing transactions. To the extent that the proposed rules increase the likelihood that banking regulators that have implemented the Basel III framework in their jurisdiction recognize covered clearing agencies as QCCPs, banks that clear at covered clearing agencies will experience lower capital requirements. Since clearing agencies may compete for volume from clearing members that are also banks, the proposed rules may remove a competitive friction between covered clearing agencies and other clearing agencies that enjoy recognition as QCCPs by banking regulators. As a corollary, the proposed rules could potentially disadvantage any registered clearing agencies that are not covered clearing agencies.[696] The Commission also preliminarily notes that the ability of registered clearing agencies to voluntarily apply for covered clearing agency status under proposed Rule 17Ab2-2(a) may potentially allow entrants to achieve QCCP status if the Commission determines they should receive covered clearing agency status and they otherwise meet the requirements of the Basel III framework.

Further competitive effects may flow from the proposal as a result of the determinations under proposed Rule 17Ab2-2 for clearing agencies engaged in activities with a more complex risk profile and clearing agencies that are systemically important in multiple jurisdictions. These entities will be responsible for maintaining additional financial resources sufficient to cover the default of the two participant families that would potentially cause the largest aggregate credit exposures in extreme but plausible market conditions as well as undertake an annual feasibility analysis for extending liquidity risk management from "cover one" to "cover two." These clearing agencies will have to collect these resources from participants, either through higher margin requirements or guaranty fund contributions, or indirectly through third-party borrowing arrangements secured by member resources. Regardless of how clearing agencies obtain these additional resources, the requirement to do so potentially raises the costs to use services provided by covered clearing agencies which could, at the margin, shift transactional volume to clearing

696 See supra note 593 (noting that the Commission currently expects the lower capital treatment under the Basel III framework to affect registered clearing agencies FICC, ICEEU; and OCC, each of which would meet the definition of a "covered clearing agency" under the proposed rules).

agencies that fall outside the scope determined by proposed Rule 17Ab2-2, where competing clearing agencies exist, or opt out of clearing altogether.

b. Efficiency

The proposed amendments to Rule 17Ad-22 may affect efficiency in a number of ways, though as discussed previously, most of these effects will only flow to the extent that covered clearing agencies do not already comply with the proposed amendments. First, because the proposed amendments result in general consistency with the standards set forth in the PFMI Report and requirements proposed by the Board and adopted by the CFTC, consistency likely fosters efficiency by reducing the risk that covered clearing agencies will be faced with conflicting or duplicative regulation when clearing financial products across multiple regulatory jurisdictions.

Consistency across regulatory regimes in multiple markets may also result in efficiency improvements. Fully integrated markets would allow clearing agencies to more easily exploit economies of scale because clearing agencies tend to have low marginal costs and, thus, could provide clearance and settlement services over a larger volume of transactions at a lower average cost. Differences in regulation, on the other hand, may result in market fragmentation, allowing clearing agencies to operate as local monopolists. The resulting potential for segmentation of clearing and settlement businesses along jurisdictional lines may lead to overinvestment in the provision of clearing services and reductions in efficiency as clearing agencies open and operate solely within jurisdictional boundaries. If market segmentation precludes covered clearing agencies from clearing transactions for customers located in another jurisdiction with a market too small to support a local clearing agency, fragmentation may result in under-provisioning of clearing and settlement services in these areas, in turn reducing the efficiency with which market participants share risk.

The proposed amendments may also affect efficiency directly if they mitigate covered clearing agencies' incentives to underinvest in risk management and recovery and wind-down procedures. CCP default and liquidation is likely a costly event, so to the extent that the proposed rules mitigate the risk of CCP default and prescribe rules for orderly recovery and wind-down, they will produce efficiency benefits. Another direct effect on efficiency may come if registered clearing agencies attempt to restructure their operations in ways that would allow them to fall outside of the scope of proposed Rule 17Ad-22(e).

Finally, price efficiency and the efficiency of risk sharing among market participants may be affected by the proposed amendments. On one hand, the cost of a transaction includes costs related to counterparty default that are typically unrelated to fundamental asset payoffs. Academic research using credit default swap transaction data has revealed a statistically significant, though economically small, relationship between the credit risk of a counterparty and the spreads implicit in transaction prices.[697] Enhanced risk management by clearing agencies may reduce this component of transaction costs. By reducing deviations of prices from fundamental value, the proposed amendments may increase price efficiency. If lower transaction costs or reduced ambiguity facilitates participation in cleared markets by investors who would

[697] See e.g., Navneet Arora, Priyank Gandhi & Francis Longstaff, Counterparty Credit Risk and the Credit Default Swap Market, 103 J. Fin. Econ. 280 (2012). Using transaction prices and quotes by 14 different CDS dealers, the authors identified how dealers' credit risk affects transaction prices. They observed a relationship between spreads and credit risk implying that a 645-basis-point increase in a dealer's credit spread would produce a one-basis-point increase in transaction prices. They explain the magnitude of this relationship by noting that their sample included transactions that were mostly collateralized, which would diminish the sensitivity of transaction prices to counterparty credit risk.

benefit from opportunities for risk-sharing in these markets,[698] then this transmission channel may result in more efficient allocation of risk. On the other hand, the proposed amendments may have adverse implications for price efficiency in cleared markets if they drive up transaction costs as higher costs of risk management enter asset prices. An increase in transaction costs could cause certain market participants to avoid trading altogether, reducing liquidity in cleared products and opportunities for risk sharing among investors in these markets.

c. Capital Formation

The implications for capital formation that flow from these proposed rules stem mainly from incremental costs that result from compliance with more specific standards and benefits in the form of more efficient risk sharing.

In cases where current practice falls short of the proposed amendments, covered clearing agencies may have to invest in infrastructure or make other expenditures to come into compliance, which may divert capital from other uses. In line with our previous discussion of cost allocation in the market for clearing services, these resources may come from clearing members and their customers.[699]

At the same time, the Commission preliminarily believes that the standards contemplated under the proposed rules may foster capital formation. As mentioned earlier, clearing agencies that are less prone to failure may help reduce transaction costs in the markets they clear.[700]

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698 If investors who might benefit from risk-sharing in cleared markets are ambiguity-averse, then regulation that addresses payoffs in times of financial strain may induce their participation. See supra note 655 and accompanying text.

699 See supra Part IV.C.1 (discussing the economic effects of the proposed rules on the market for clearing services generally).

700 See supra Part IV.C.1.a (discussing the general economic effects of the proposed rules on systemic risk).

Conceptually, the component of transaction costs that reflects counterparty credit risk insures one counterparty against the default of another.[701] Reductions in counterparty default risk allow the corresponding portion of transaction costs to be allocated to more productive uses by market participants who otherwise would bear these costs.

If, on balance, the proposed amendments cause transaction costs to decrease in cleared markets, then the expected value of trade may increase. Counterparties that are better able to diversify risk through participation in cleared markets may be more willing to invest in the real economy rather than choosing to engage in precautionary savings.

3. Effect of Proposed Amendments to Rule 17Ad-22 and Proposed Rule 17Ab2-2

The discussion below outlines the costs and benefits preliminarily considered by the Commission as they relate to the rules being proposed today. These specific costs and benefits are in addition to the more general costs and benefits anticipated under the Commission's proposal discussed in Part IV.C.1 and include, in particular, the costs and benefits stemming from the availability of QCCP status under the Basel III capital requirements. Many of the costs and benefits discussed below are difficult to quantify. This is particularly true where clearing agency practices are anticipated to evolve and adapt to changes in technology and other market developments. The difficulty in quantifying costs and benefits of the proposed rules is further exacerbated by the fact that in some cases the Commission lacks information regarding the specific practices of clearing agencies that could assist in quantifying certain costs. For example, as noted in Part IV.C.3.a.iv(4), without detailed information about the composition of illiquid assets held by clearing agencies and their members, the Commission cannot provide reasonable

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[701] See supra note 697.

estimates of costs associated with satisfying substantive requirements under proposed Rules 17Ad-22(e)(7)(i) and (ii). Another example, discussed in Part IV.C.3.a.iv(5), is testing and validation of financial risk models, where the Commission is only able to estimate that costs will fall within a range. In this case, the costs associated with substantive requirements under the proposed rules may depend on the types of risk models employed by clearing agencies, which are, in turn, dictated by the markets they serve. As a result, much of the discussion is qualitative in nature, though where possible, the costs and benefits have been quantified.

a. Proposed Rule 17Ad-22(e)

The Commission recognizes that the scope of the proposed rules is an important determinant of their economic effect. Having considered the anticipated costs associated with the proposed rules, the Commission preliminarily believes that it is appropriate to limit the application of proposed Rule 17Ad-22(e) to covered clearing agencies, as these are the registered clearing agencies for which the benefits of the proposed rules are the greatest. In particular, as discussed below, the Commission preliminarily believes that an important benefit resulting from the enhanced risk management requirements in the proposed rules is a reduction in the risk of a failure of a covered clearing agency. For example, for designated clearing agencies these benefits may be significant due to their size, exposure to, and interconnectedness with market participants, and the effect their failure may have on markets, market participants, and the broader financial system. For complex risk profile clearing agencies, significant benefits may flow as a result of their higher baseline default risk.

As an alternative, the Commission could have proposed to extend the scope of proposed Rule 17Ad-22(e) to cover all registered clearing agencies. The Commission preliminarily acknowledges, however, that costs of compliance with the proposed rules may represent barriers to entry for clearing agencies. By continuing to apply Rule 17Ad-22(d) to registered clearing agencies that are not covered clearing agencies, the Commission preliminary believes that the proposed scope Rule 17Ad-22(e) appropriately preserves the potential for innovation in the establishment and operation of registered clearing agencies.[702] Moreover, including CME and ICE in the set of covered clearing agencies would potentially subject them to requirements that would be duplicative of CFTC requirements.

i. Proposed Rule 17Ad-22(e)(1): Legal Risk

Because, as noted above, proposed Rule 17Ad-22(e)(1) would require substantially the same set of policies and procedures as Rule 17Ad-22(d)(1),[703] the Commission preliminarily believes that proposed Rule 17Ad-22(e)(1) would likely impose limited material additional costs on covered clearing agencies and produce limited benefits, in line with the general economic considerations discussed in Part IV.C.1.

ii. Proposed Rule 17Ad-22(e)(2): Governance

Each covered clearing agency has a board of directors that governs its operations and oversees its senior management. Proposed Rule 17Ad-22(e)(2) would establish more detailed requirements for governance arrangements at covered clearing agencies relative to those imposed on registered clearing agencies under Rule 17Ad-22(d)(8).[704]

[702] The Commission notes that under proposed Rule 17Ab2-2(a), a registered clearing agency that is not involved in activities with a more complex risk profile and is not a designated clearing agency may apply for covered clearing agency status, which would subject them to the requirements of Rule 17Ad-22(e). The Commission preliminarily believes that this may occur if the registered clearing agency believes such status may credibly signal the quality of the services it provides or if it is seeking to obtain QCCP status under the Basel III framework.

[703] See supra note 107; supra Part II.B.1 (discussing the full set of requirements under proposed Rule 17Ad-22(e)(1)); supra Part IV.B.3.a.i (discussing current practices among registered clearing agencies regarding legal risk); see also 17 CFR 240.17Ad-22(d)(1).

[704] See supra Part II.B.2 (discussing the full set of requirements under proposed Rule 17Ad-22(e)(2) and its relationship to Rule 17Ad-22(d)(8)); see also supra note 119 (discussing how the

The Commission understands that any covered clearing agency subject to the proposed rule has policies and procedures in place that clearly prioritize the risk management and efficiency of the clearing agency. However, the Commission preliminarily believes that covered clearing agencies do not already have in place policies and procedures with respect to other requirements under proposed Rule 17Ad-22(e)(2). Based its supervisory experience, the Commission preliminarily believes that some covered clearing agencies may need to update their policies and procedures to comply with proposed Rule 17Ad-22(e)(2)(iv). These updates will entail certain basic compliance costs, and covered clearing agencies may also incur assessment costs related to analyzing current governance arrangements in order to determine the extent to determine which they do not meet the requirements of the proposed amendments. The estimated costs in terms of paperwork are discussed in Part III.D.1. If, as a result of new policies and procedures, a covered clearing agency is required to recruit new directors, the Commission preliminarily estimates a cost per director of $73,000.[705]

While there are potential costs associated with compliance, the Commission preliminarily believes that benefits would potentially accrue from these requirements. Specifically, the Commission preliminarily believes that enhanced governance arrangements would further promote safety and efficiency at the clearing agency—motives that may not be part of a clearing agency's governance arrangements in the absence of regulation. Policies and procedures required under the proposed rules would also reinforce governance arrangements at covered

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proposed rule would complement other proposed requirements concerning governance at clearing agencies that may apply separately).

[705] The Commission estimated a cost per director of $68,000 in proposing Regulation MC. See Exchange Act Release No. 34-63107 (Oct. 14, 2010), 75 FR 65881, 65921 & n.215 (Oct. 26, 2010). The $73,000 estimate reflects this amount in 2013 dollars, using consumer price inflation data provided by the Bureau of Labor Statistics.

clearing agencies by requiring board members and senior management to have appropriate experience and skills to discharge their duties and responsibilities.

Compliance with these proposed requirements could reduce the risk that insufficient internal controls within a covered clearing agency endanger broader financial stability. While the benefits of compliance are difficult to quantify, the Commission preliminarily believes that they flow predominantly from a reduced probability of covered clearing agency default.

iii. Proposed Rule 17Ad-22(e)(3): Comprehensive Framework for the Management of Risks

The Commission preliminarily believes that proposed Rule 17Ad-22(e)(3) would aid covered clearing agencies in implementing a systematic process to examine risks and assess the probability and impact of those risks.[706] Proposed Rule 17Ad-22(e)(3)(i) specifies that a risk management framework include policies and procedures reasonably designed to identify, measure, monitor, and manage the range of risks that arise in or are borne by the covered clearing agency. Critically, these policies and procedures would be subject to review on a specified basis and approval by the board of directors annually. A sound framework for comprehensive risk management under regular review would have the benefits of providing covered clearing agencies with a better awareness of the totality of risks they face in the dynamic markets they serve. In addition, the requirement to have policies and procedures that provide for an independent audit committee of the board and that provide internal audit and risk management functions with sufficient resources, authority, and independence from management, as well as access to risk and audit committees of the board, would reinforce governance arrangements directly related to risk management at covered clearing agencies. A holistic approach to risk

[706] See supra Part II.B.3 (discussing the full set of requirements under proposed Rule 17Ad-22(e)(3)).

management could help ensure that policies and procedures that covered clearing agencies adopt pursuant to the proposed rules work in tandem with one another. For example, such an approach could result in risk-based membership standards under proposed Rule 17Ad-22(e)(18) that are consistent with policies and procedures related to the allocation of credit losses under proposed Rule 17Ad-22(e)(13)(i). The Commission preliminarily believes ensuring that a covered clearing agency's risk management activities fit within a unified framework could mitigate the risk of financial losses to covered clearing agencies' members and participants in the markets they serve.

Additionally, the proposed rule extends requirements under Rules 17Ad-22(d)(4) and 17Ad-22(d)(11) by requiring plans for recovery and wind-down.[707] To the extent that covered clearing agencies do not already have such plans in place, they may incur additional incremental costs. Plans for recovery and wind-down benefit both clearing members and, more generally, participants in markets where products are cleared. Many of the costs and benefits of such plans depend critically on the specific recovery and wind-down tools that covered clearing agencies choose to include in their rules. The presence of such plans could reduce uncertainty over the allocation of financial losses to clearing members in the event that a covered clearing agency faces losses due to member default or for other reasons that exceed its prefunded default resources. Further, recovery and wind-down plans that detail the circumstances under which clearing services may be suspended or terminated may mitigate the risk of market disruption in periods of financial stress. Market participants who face the possibility that the assets they trade may no longer be cleared and settled by a CCP may be unwilling to trade such assets at times

707 See supra Part II.B.3.b (discussing the requirements for recovery and orderly wind-down plans under proposed Rule 17Ad-22(e)(3)(ii)).

when risk sharing is most valuable. While the effects are difficulty to quantify, the Commission preliminarily believes that recovery and wind-down plans may support liquidity in times of financial stress.

Based on its supervisory experience, the Commission preliminarily believes that all covered clearing agencies have an independent audit committee of the board and most covered clearing agencies already have some rules governing recovery and wind-down of clearing operations but have plans that vary in their degree of formality. As a result, the benefits and costs associated with these requirements will likely be limited to incremental changes associated with covered clearing agencies' review of their policies and procedures for recovery and wind-down and to registered clearing agencies that move into the set of covered clearing agencies.

iv. Proposed Rules 17Ad-22(e)(4) through (7): Financial Risk Management

(1) Proposed Rule 17Ad-22(e)(4): Credit Risk

Proposed Rule 17Ad-22(e)(4) would establish requirements for credit risk management by covered clearing agencies.[708] Based on its supervisory experience, the Commission preliminarily believes that all entities that would be covered clearing agencies are already in compliance with proposed Rules 17Ad-22(e)(4)(i) through (iv). Pursuant to Rule 17Ad-22(b)(3), registered clearing agencies that provide CCP services currently maintain additional financial resources to meet the "cover one" requirement, and registered clearing agencies that would be complex risk profile clearing agencies under the proposed rules currently maintain financial

708 See supra Part II.B.4.c (discussing the full set of requirements under proposed Rule 17Ad-22(e)(4)).

resources to meet the "cover two" requirement.[709] All covered clearing agencies exclude resources that are not prefunded when calculating this coverage.[710] As a result, the Commission preliminarily believes little or no additional direct costs or benefits will result from these requirements unless registered clearing agencies were to become covered clearing agencies and include resources that are not prefunded towards their resource requirements. The requirement to include only prefunded resources when calculating the financial resources available to meet the standards under proposed Rules 17Ad-22(e)(4)(i) through (iii) potentially reduces the risk that covered clearing agencies request financial resources from their members in times of financial stress, when members are least able to provide these resources.

While requiring "cover two" for complex risk profile clearing agencies and for covered clearing agencies designated systemically important in multiple jurisdictions would place additional burdens on the affected clearing agencies, the Commission preliminarily believes that the requirement is appropriate because disruption to these entities due to member default carries relatively higher expected costs than for other covered clearing agencies. These relatively higher expected costs arise from the fact that covered clearing agencies designated systemically important in multiple jurisdictions are exposed to foreign financial markets and may serve as a conduit for the transmission of risk; for complex risk profile clearing agencies, high expected

709 The Commission also notes that no covered clearing agency would be systemically important in multiple jurisdictions unless and until the Commission made such a determination pursuant to proposed Rule 17Ab2-2. See supra Part II.C and infra Part VII (discussing the determinations process under proposed Rule 17Ab2-2 and providing proposed rule text, respectively).

710 See supra Part IV.B.3.b.i (discussing current practices regarding credit risk management at registered clearing agencies).

costs may arise from discrete jump-to-default price changes in the products they clear and higher correlations in the default risk of members.[711]

Proposed Rule 17Ad-22(e)(4)(vi) and (vii) would also impose additional costs by requiring additional measures to be taken with respect to the testing of a covered clearing agency's financial resources and model validation of a covered clearing agency's credit risk models. These requirements do not currently exist as part of the standards applied to registered clearing agencies.[712] Covered clearing agencies may incur additional costs under expanded and more frequent testing of total financial resources if the formal requirement that results of monthly testing be reported to appropriate decision makers is a practice not currently used by covered clearing agencies. A range of costs for these new requirements is discussed in Part IV.C.3.a.iv(5).

Frequent monitoring and stress testing of total financial resources, conforming model validations, and reporting of results of the monitoring and testing to appropriate personnel within the clearing agency could help rapidly identify any gaps in resources required to ensure stability, even in scenarios not anticipated on the basis of historical data. Moreover, the requirement to test and, when necessary, update the assumptions and parameters supporting models of credit risk will support the adjustment of covered clearing agency financial resources to changing financial conditions, and mitigate the risk that covered clearing agencies will strategically manage updates to their risk models in support of cost reduction or profit maximization.

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711 Cf. PFMI Report, supra note 1, at 43 (discussing Principle 4, Explanatory Note 3.4.19).

712 Rule 17Ad-22(b)(4) requires a registered clearing agency's policies and procedures be reasonably designed to provide for an annual validation of its margin models and the related parameters and assumptions. See 17 CFR 240.17Ad-22(b)(4).

(2) Proposed Rule 17Ad-22(e)(5): Collateral

Proposed Rule 17Ad-22(e)(5) would require a covered clearing agency to have policies and procedures reasonably designed to limit the assets it accepts as collateral to those with low credit, liquidity, and market risks, and to set and enforce appropriately conservative haircuts and concentration limits. Collateral haircut and concentration limit models would be subject to a not-less-than-annual review of their sufficiency.[713] Rule 17Ad-22(d)(3) currently requires registered clearing agencies to have policies and procedures reasonably designed to hold assets in a manner that minimizes risk of loss or risk of delay in access to them and invest assets in instruments with minimal credit, market, and liquidity risk.

By focusing on the nature of assets and not on accounts, the Commission preliminarily believes the proposed rule may allow covered clearing agencies the ability to manage collateral more efficiently. In particular, under the proposed rule, a covered clearing agency would have the option of accepting collateral that is riskier than cash and holding this collateral at commercial banks, potentially increasing default risk exposure. On the other hand, the requirement to regularly review concentration limits and haircuts mitigates the risk that a covered clearing agency's collateral policies fail to respond to changing economic conditions. Based on its supervisory experience, the Commission understands that all registered clearing agencies that would meet the definition of a covered clearing agency already conform to the requirements under the proposed rule related to the nature of assets they may accept as collateral and the haircuts and concentration limits they apply to collateral assets, so the associated costs

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713 See supra Part II.B.4.d (discussing the full set of requirements under proposed Rule 17Ad-22(e)(5)).

and benefits that would result from these requirements would apply only if registered clearing agencies not already in compliance were to become covered clearing agencies.

As a result of the proposed rule, these covered clearing agencies and registered clearing agencies that become covered clearing agencies may experience additional costs as a result of the proposed annual review requirements for the sufficiency of collateral haircut and concentration limit models. Based on its supervisory experience, the Commission preliminarily believes that many clearing agencies that require collateral would need to develop policies and procedures to review haircuts and concentration limits annually. Enforcement of the proposed haircut requirement would also require additional resources. A range of costs for these new requirements is discussed in Part IV.C.3.a.iv(5). Adherence to the new requirements by these entrants could extend the benefits of prompt loss coverage, incentive alignment, and systemic risk mitigation to a larger volume of cleared transactions.

(3) Proposed Rule 17Ad-22(e)(6): Margin

Proposed Rule 17Ad-22(e)(6) would require a covered clearing agency that provides CCP services to have policies and procedures reasonably designed to require it to cover credit exposures using a risk-based margin system and to establish minimum standards for such a system. It would require these policies and procedures to cover daily collection of variation margin. The proposed rule also requires a set of policies and procedures generally designed to support a reliable margin system. Among these are policies and procedures to ensure the use of reliable price data sources and appropriate methods for measuring credit exposure, which could improve margin system accuracy. Finally, covered clearing agencies would be required to have policies and procedures related to the testing and verification of margin models.[714] Proposed Rules 17Ad-22(a)(6) and (14) support these requirements by addressing the means of verification for margin models and the level of coverage required of a margin system against potential future exposures, respectively. Based on its supervisory experience, however, the Commission understands that all current covered clearing agencies have policies and procedures that conform to the requirements under proposed Rules 17Ad-22(e)(6)(i) through (v) and (vii), and some will have to update their policies and procedures to comply with proposed Rule 17Ad-22(e)(6)(vi).

Similar to proposed Rules 17Ad-22(e)(4) and (7), covered clearing agencies that do not already engage in backtesting of margin resources at least once each day or engage in a monthly analysis of assumptions and parameters, as well as registered clearing agencies that enter into the set of covered clearing agencies in the future, may incur incremental compliance costs as a result of the proposed rule. Since margin plays a key role in clearing agency risk management, however, requiring that margin be periodically verified and modified as a result of changing market conditions may mitigate the risks posed by covered clearing agencies to financial markets in periods of financial stress. Further, periodic review of model specification and parameters reduces the likelihood that covered clearing agencies opportunistically update margin models in times of low volatility and fail to update margin models in times of high volatility. A range of costs for verification and modification of margin models is discussed in Part IV.C.3.a.iv(5). Further, since risk-based initial margin requirements may cause market participants to internalize some of the costs borne by the CCP as a result of large or risky positions,[715] ensuring that margin

714 See supra Part II.B.4.e (discussing the full set of requirements under proposed Rule 17Ad-22(e)(6)).

715 See e.g., Philipp Haene & Andy Sturm, Optimal Central Counterparty Risk Management (Swiss Nat'l Bank Working Paper, June 2009) (addressing the tradeoff between margin and

models are well-specified and correctly calibrated with respect to economic conditions will help ensure that they continue to align the incentives of clearing members with the goal of financial stability.

(4) **Proposed Rule 17Ad-22(e)(7): Liquidity Risk**

Proposed Rule 17Ad-22(e)(7) would require a covered clearing agency to have policies and procedures reasonably designed to effectively monitor, measure, and manage liquidity risk.[716] Parties to securities and derivatives transactions rely on clearing agencies for prompt clearance and settlement of transactions. Market participants in centrally cleared and settled markets are often linked to one another through intermediation chains in which one party may rely on proceeds from sales of cleared products to meet payment obligations to another party. If insufficient liquidity causes a clearing agency to fail to meet settlement or payment obligations to its members, consequences could include the default of a clearing member who may be depending on these funds to make a payment to another market participant, with losses then transmitted to others that carry exposure to this market participant if the market participant is depending on payments from the clearing members to make said payments to others. Therefore, the benefits related to liquidity risk management generally flow from the reduced risk of systemic risk transmission by covered clearing agencies as a result of liquidity shortfalls, either in the normal course of operation or as a result of member default.

Enhanced liquidity risk management may produce additional benefits. Clearing members would face less uncertainty over whether a covered clearing agency has the liquidity resources

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default fund, considering collateral costs, clearing member default probability, and the extent to which margin requirements are associated with risk mitigating incentives).

[716] See supra Part II.B.4.f (discussing the full set of requirements under proposed Rule 17Ad-22(e)(7)).

necessary to make prompt payments which would reduce any need to hedge the risk of nonpayment. Potential benefits from enhanced liquidity risk management may also extend beyond members of covered clearing agencies or markets for centrally cleared and settled securities. Clearing members are often members of larger financial networks, and the ability of a covered clearing agency to meet payment obligations to its members can directly affect its members' ability to meet payment obligations outside of the cleared market. Thus, management of liquidity risk may mitigate the risk of contagion between asset markets.

Based on its supervisory experience, the Commission preliminarily believes that some covered clearing agencies would need to create new policies and procedures, or update existing policies and procedures, to meet requirements under the various subsections of proposed Rule 17Ad-22(e)(7). These actions would entail compliance costs, as noted in Part III.B.2. Further, the Commission preliminarily believes that for some covered clearing agencies the proposed requirements would require them to establish new practices. The cost of adherence to the proposed rule would likely be passed on to market participants in cleared markets, as discussed in more detail below.

Under proposed Rule 17Ad-22(e)(7)(i), a covered clearing agency would be required to have policies and procedures reasonably designed to require maintaining sufficient resources to achieve "cover one" for liquidity risk. This requirement mirrors the "cover one" requirement for credit risk in proposed Rule 17Ad-22(e)(4)(iii). Based on its supervisory experience, the Commission preliminarily believes that many covered clearing agencies do not currently meet a "cover one" requirement for liquidity and thus will likely incur costs to comply with this proposed rule. As discussed earlier, whether covered clearing agencies choose to gather liquidity directly from members or instead choose to rely on third-party arrangements, the costs of liquidity may be passed on to other market participants, eventually increasing transaction costs.[717] The requirement may, however, reduce the procyclicality of covered clearing agencies' liquidity demands, which may reduce costs to market participants in certain situations. For instance, the requirement would reduce the likelihood that a covered clearing agency would have to call on its members to contribute additional liquidity in periods of financial stress, when liquidity may be most costly.

Under proposed Rule 17Ad-22(e)(7)(ii), a covered clearing agency would be required to have policies and procedures reasonably designed to ensure that it meets the minimum liquidity resource requirement in proposed Rule 17Ad-22(e)(7)(i) with qualifying liquid resources.[718] Qualifying liquid resources would include cash held at the central bank or at a creditworthy commercial bank, assets that are readily converted into cash pursuant to committed lines of credit, committed foreign exchange swaps, committed repurchase agreements or other highly reliable prearranged funding agreements, or assets that may be pledged to a central bank in exchange for cash (if the covered clearing agency has access to routine credit at a central bank). The Commission notes that the proposed rules allow covered clearing agencies some measure of flexibility in managing qualifying liquid resources and that covered clearing agencies would be able to use creditworthy commercial bank services where appropriate.

Based on its supervisory experience, the Commission preliminarily believes that some covered clearing agencies currently do not meet the proposed liquidity requirements with qualifying liquid resources. As an alternative to the proposed rules, the Commission could have

[717] See supra Part IV.C.1.d (discussing the effect of the proposed rules on concentration in the market for clearing services and among clearing members).

[718] See proposed Rule 17Ad-22(a)(15), infra Part VII (defining "qualifying liquid resources").

restricted the definition of qualifying liquid resources to assets held by covered clearing agencies. These covered clearing agencies and the markets they serve would benefit from the proposed minimum requirements for liquidity resources in terms of the reduced risk of liquidity shortfalls and associated contagion risks described above. However, qualifying liquid resources may be costly for covered clearing agencies to maintain on their own balance sheets. Such resources carry an opportunity cost. Assets held as cash are, by definition, not available for investment in less liquid assets that may be more productive uses of capital. This cost may ultimately be borne by clearing members who contribute liquid resources to covered clearing agencies to meet minimum requirements under proposed Rule 17Ad-22(e)(7)(ii) and their customers.

The Commission notes that, under the proposed rules, covered clearing agencies have flexibility to meet their qualifying liquid resource requirements in a number of ways. In perfect capital markets, maintaining on-balance-sheet liquidity resources should be no more costly than entering into committed lines of credit or prearranged funding agreements backed by less-liquid assets that would allow these assets to be converted into cash. However, market frictions, such as search frictions, may enable banks to obtain liquidity at lower cost than other firms. In the presence of such frictions, obtaining liquidity using committed and uncommitted funding arrangements provided by banks may prove a less costly option for some covered clearing agencies than holding additional liquid resources on their balance sheets. In particular, the Commission preliminarily believes that requiring covered clearing agencies to enter into committed or uncommitted funding arrangements would decrease the costs that would be experienced by them in the event they sought to liquidate securities holdings during periods of market disruptions and increase the likelihood that they meet funding obligations to market participants by reducing the risk of delay in converting non-cash assets into cash.

The Commission notes that committed or uncommitted funding arrangements would only count towards minimum requirements to the extent that covered clearing agencies had securities available to post as collateral, so use of these facilities may require covered clearing agencies to require their members to contribute more securities. If these securities are costly for clearing members to supply, then additional required contributions to meet minimum requirements under proposed Rule proposed Rule 17Ad-22(e)(7)(ii) may impose burdens on clearing members and their customers. Similarly, prearranged funding arrangements may entail implicit costs to clearing members. Prearranged funding arrangements could impose costs on clearing members if they are obligated to contribute securities towards a collateral pool that the covered clearing agency would use to back borrowing. Alternatively, clearing members may be obligated under a covered clearing agency's rules to act as counterparties to repurchase agreements. Under the latter scenario, clearing members would bear costs associated with accepting securities in lieu of cash. Additionally, the Commission notes certain explicit costs specifically associated with these arrangements outlined below.

Counterparties to committed arrangements allowable under proposed Rule 17Ad-22(a)(15) charge covered clearing agencies a premium to provide firm liquidity commitments and additional out-of-pocket expenses will be incurred establishing and maintaining committed liquidity arrangements. The Commission preliminarily estimates that the total cost of committed funding arrangements will be approximately 30 basis points per year, including upfront fees, legal fees, commitment fees, and collateral agent fees.[719] Furthermore, the Commission is aware of other potential consequences of these arrangements. In some instances, they may cause entities outside of a covered clearing agency to bear risks ordinarily concentrated within the covered clearing agency, while, in others, these arrangements may result in increased exposure of covered clearing agencies to certain members.[720] Financial intermediaries that participate in committed credit facilities may be those least able to provide liquidity in times of financial stress, so these commitments may represent a route for risk transmission.[721] Finally, the Commission notes that covered clearing agencies may face constraints in the size of credit facilities available to them. Recent market statistics have estimated the total size of the committed credit facility market in the U.S. at $1.2 trillion with only 12 of 1800 facilities exceeding $10 billion in size.[722] Given the volume of activity at covered clearing agencies, it is possible that they may only be able to use committed credit facilities to meet a portion of their liquidity requirements under proposed Rule 17Ad-22(e)(7)(ii).

A covered clearing agency may alternatively use a prearranged funding arrangement determined to be highly reliable in extreme but plausible market conditions to raise liquid

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719 See Letter from Kim Taylor, President, CME Clearing, to Melissa Jurgens, Office of the Secretariat, CFTC, Sept. 16, 2013, at 13 & n.48 (noting CME's assumption that the cost of committed liquidity or committed repurchase facilities is approximately $3 million for every $1 billion of required committed facilities, including upfront fees, commitment fees, legal fees, and collateral agent fees).

720 See id. at 11.

721 See Letter from Robert C. Pickel, CEO, ISDA to Secretary, CFTC, Sept. 16, 2013, at 4 (discussing collateral and liquidity requirements); see also Craig Pirrong, Clearing and Collateral Mandates: A New Liquidity Trap?, 24 J. Applied Corp. Fin. 67 (2012).

722 See Bloomberg, Global Syndicated Loans, 1st Half 2013 League Tables (July 1, 2013), available at http://www.bloomberg.com/professional/files/2012/08/Global-Syndicated-Loans-2012.pdf.

resources backed by non-cash assets but that does not require firm commitments from liquidity providers. This strategy would avoid certain of the explicit fees associated with firm commitments, while incurring costs related to the annual review and maintenance of such arrangements. Based on its supervisory experience and discussions with market participants, the Commission preliminarily believes the cost associated with commitment fees to be between 5 and 15 basis points per year. Given the 30 basis point cost associated with committed funding arrangements, mentioned above, uncommitted facilities could entail costs of between 15 and 25 basis points.[723] Prearranged funding arrangements may ultimately prove less costly than holding cash and may be more widely available than committed arrangements, while still reducing the likelihood of delay faced by covered clearing agencies that attempt to market less-liquid assets. As mentioned above in the context of committed credit facilities, the Commission acknowledges that financial institutions who offer to provide liquidity to covered clearing agencies on an uncommitted basis may be least able to do so in times of financial stress, when access to liquidity is most needed by the covered clearing agency. Without a commitment in place, counterparties retain the option to fail to provide liquidity during stressed conditions, when liquidity is most valuable to clearing agencies and the markets they serve. To the extent covered clearing agencies may establish requirements for clearing members to provide liquidity to ensure compliance with the Commission's proposed rules, the costs experienced by members indirectly may exceed those associated with committed credit facilities.

723 Subtracting the lower bound of commitment fees (5 basis points) from the estimated total cost of a committed facility (30 basis points) yields an estimate of the upper bound of the fees associated with an uncommitted facility (30 - 5 = 25 basis points). We estimate the lower bound of fees associated with an uncommitted facility analogously (30 - 15 = 15 basis points).

Finally, covered clearing agencies that have access to routine credit at a central bank could meet the qualifying liquid resources requirement with assets that are pledgeable to a central bank. The Commission notes that this may represent the lowest cost option for covered clearing agencies, but understands that this latter provision would represent an advantage only if and when a covered clearing agency receives the benefit of access to routine central bank borrowing. The Commission anticipates that at such future time access to routine credit at a central bank would provide covered clearing agencies with additional flexibility with respect to resources used to comply with the liquidity risk management requirements of proposed Rules 17Ad-22(e)(7)(i) and (ii).

The total cost of maintaining qualifying liquid resources pursuant to proposed Rules 17Ad-22(e)(7)(i) and (ii) is composed of the cost of each liquidity source including assets held by covered clearing agencies, committed credit facilities and prearranged funding agreements, multiplied by the quantity of each of these liquidity sources held by covered clearing agencies. The Commission is unable to quantify the cost of cash held by clearing agencies and securities required to back credit facilities since such estimates would require detailed information about additional required contributions of clearing members under the proposed rules, as well as clearing members' best alternative to holding cash and securities.[724] As mentioned above, however, the Commission has limited information about the costs associated with committed and uncommitted credit facilities. Based on this information, we are able to quantify the costs associated with committed credit facilities that will result from the requirement to maintain

[724] Covered clearing agencies may choose to allocate liquidity burdens based on a number of factors related to the markets they serve and their membership. See, e.g., Exchange Act Release No. 34-70999 (Dec. 5, 2013), 78 FR 75400 (Dec. 11, 2013) (Commission order approving NSCC rule change to institute supplemental liquidity deposits to its clearing fund designed to increase liquidity resources to meet its liquidity needs).

qualifying liquid resources. The Commission preliminarily estimates that the cost of compliance with the proposed rules will be between $133 million and $225 million per year as a result of the requirement to enter into prearranged funding agreements for non-cash assets used to meet liquidity requirements under proposed Rules 17Ad-22(e)(7)(i) and (ii). This analysis assumes that covered clearing agencies will enter into such agreements at arm's length on an uncommitted basis. Based on staff discussions with market participants, the Commission understands that alternative arrangements between covered clearing agencies and their members may be obtained at lower cost, though these arrangements may come with increased wrong-way risk.[725]

U.S. Treasury securities would not fall under the proposed definition of qualifying liquid resources. The Commission understands that U.S. Treasury markets represent some of the largest and most liquid markets in the world, see Part IV.B.3.f.ii, and that, in "flights to quality" and "flights to liquidity" in times of financial stress, U.S. Treasuries trade at a premium to other

725 To produce this range, the Commission used a combination of publicly available information from SRO rule filings, comment letters, and 2012 annual financial statements, and non-public information gathered as a result of its regulatory role. For each covered clearing agency, the Commission assumed that the covered clearing agency's guaranty fund represents the sole source of liquidity used to satisfy its minimum liquidity requirements under the proposed rules. To compute the level of qualifying liquid resources currently held by each covered clearing agency, the Commission assumed that cash in the covered clearing agency's guaranty fund remains fixed at current levels and added to this any amount from credit facilities that could be backed by the value of securities held in the covered clearing agency's guaranty funds.

Taking the sum of these current qualifying liquid resources over all covered clearing agencies and subtracting this from the sum of the "cover one" guaranty fund requirement over all covered clearing agencies results in the total shortfall relative to minimum requirements under proposed Rules 17Ad-22(e)(7)(i) and (ii). The Commission further assumed that covered clearing agencies would cover this shortfall using prearranged funding agreements backed by additional securities posted to guaranty funds by clearing members. Finally, the Commission multiplied the total prearranged funding amount by between 0.15% and 0.25% to arrive at a range of ongoing costs.

assets.[726] If, as an alternative to the proposed rules, the Commission included U.S. government securities in the definition of qualifying liquid resources, the Commission preliminarily estimates the cost of complying with requirements under proposed Rule 17Ad-22(e)(7)(i) and (ii) would be reduced by between $9 million and $225 million per year.[727] The Commission preliminarily believes, however, that there are benefits to including government securities only if prearranged funding agreements exist. In particular, given the quantity of these securities financed by the largest individual dealers, fire-sale conditions could materialize if collateral is liquidated in a

726 See Alessandro Beber, Michael W. Brandt & Kenneth A. Kavajecz, Flight-to-Quality or Flight-to-Liquidity? Evidence from the Euro-Area Bond Market, 22 Rev. Fin. Stud. 925 (2009) (decomposing sovereign yield spreads into credit and liquidity components and showing that credit quality matters for bond valuation but that, in times of market stress, investors chase liquidity, not quality); Markus K. Brunnermeier & Lasse Heje Pedersen, Market Liquidity and Funding Liquidity, 22 Rev. Fin. Stud. 2201 (2009) (showing, in a theoretical model, how with low wealth shocks, demand for illiquid assets falls off more sharply than demand for liquid assets); Francis A. Longstaff, The Flight-to-Liquidity Premium in U.S. Treasury Bond Prices, 77 J. Bus 511 (2004) (estimating the liquidity premium associated with U.S. Treasuries relative to close substitutes); Dimitri Vayanos Flight to Quality, Flight to Liquidity, and the Pricing of Risk (NBER Working Paper No. 10327, Feb. 2004) (showing, in a theoretical model, that during volatile times, assets' liquidity premia increase), available at http://www.nber.org/papers/w10327.pdf.

727 The Commission re-estimated the level of prearranged funding agreements required to meet requirements under proposed Rules 17Ad-22(e)(7)(i) and (ii) using the data and methodology described in note 725, except in this case the Commission assumed that all non-defaulting member resources applied to funding obligations were a mix of cash and U.S. Treasuries for a lower bound, and assumed that all resources applied to funding obligations were a mix of cash and U.S. Treasuries for an upper bound.

Taking the sum of these current qualifying liquid resources over all covered clearing agencies and subtracting this from the sum of cover one guaranty fund requirement over all covered clearing agencies results in the total shortfall relative to minimum requirements under proposed Rules 17Ad-22(e)(7)(i) and (ii) if U.S. government and agency securities were considered qualifying liquid resources. As above, the Commission further assumed that covered clearing agencies would cover this shortfall using prearranged funding agreements backed by additional securities posted to guaranty funds by clearing members and multiplied this amount by between 0.15% and 0.25% to arrive at a range of ongoing costs.

disorderly manner, which could prevent covered clearing agencies from meeting payment obligations.[728]

Proposed Rule 17Ad-22(e)(7)(iii) concerns access to accounts and services at a central bank, when available and where practical.[729] The Commission preliminarily believes that it may be beneficial for covered clearing agencies to use central bank account services because doing so would reduce exposure to commercial bank default risk. Moreover, for some covered clearing agencies, central bank services may represent the lowest-cost admissible funding arrangement under the proposed rule. The Commission understands, however, that central bank services are only currently available to a subset of covered clearing agencies, and the proposed rule only requires policies and procedures to ensure use of central bank accounts and services when practical and available.

Proposed Rules 17Ad-22(e)(7)(iv) and (v) address relations between covered clearing agencies and their liquidity providers. The Commission preliminarily believes that a key benefit of these proposed rules would be an increased level of assurance that liquidity providers would be able to supply liquidity to covered clearing agencies on demand. Such assurance is especially important because of the possibility that covered clearing agencies may rely on outside liquidity providers to convert non-cash assets into cash using prearranged funding arrangements or committed facilities, pursuant to proposed Rule 17Ad-22(e)(7)(ii) and the definition of qualifying liquid resources in proposed Rule 17Ad-22(a)(15). The required policies and procedures would ensure the covered clearing agency undertakes due diligence to confirm that it

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728 Brian Begalle et al., The Risk of Fire Sales in the Tri-Party Repo Market, at 19 & n.37 (FRBNY Staff Report No. 616, May 2013), available at http://www.newyorkfed.org/research/staff_reports/sr616.pdf.

729 See proposed Rule 17Ad-22(e)(7)(iii), infra Part VII.

has a reasonable basis to believe each of its liquidity providers understand the liquidity risk borne by the liquidity provider, and that the liquidity provider would have the capacity to provide liquidity under commitments to the covered clearing agency. Finally, covered clearing agencies would be required, under the proposed rule, to maintain and test the covered clearing agency's procedures and operational capacity for accessing liquidity under their agreements. The Commission preliminarily believes that, besides the costs associated with new or updated policies and procedures discussed in Part III.B.2, covered clearing agencies and liquidity providers may experience costs associated with the proposed rules as a result of the requirement to test liquidity resources, such as, for example, fees associated with conducting test draws on a covered clearing agency's credit lines. Costs associated with ongoing monitoring and compliance related to testing are included in the Commission's estimate of quantifiable costs presented in Part IV.C.3.d.

Proposed Rules 17Ad-22(e)(7)(vi) and (vii) may impose costs on covered clearing agencies as a result of requirements for testing the sufficiency of liquidity resources and validating models used to measure liquidity risk. The testing and model validation requirements of these proposed rules are similar to requirements for testing and model validation for credit risk in proposed Rules 17Ad-22(e)(4)(vi) and (vii), and the Commission preliminarily believes that these proposed rules would yield similar benefits. Frequent monitoring and testing liquidity resources could help rapidly identify any gaps in resources required to meet payment obligations. Moreover, the requirement to test and, when necessary, update the assumptions and parameters supporting models of liquidity risk will support the adjustment of covered clearing agency liquidity resources to changing financial conditions and mitigate the risk that covered clearing agencies will strategically manage updates to their liquidity risk models in support of cost-reduction or profit-maximization.

Proposed Rule 17Ad-22(e)(7)(viii) addresses liquidity shortfalls at a covered clearing agency, and the Commission preliminarily believes the proposed rule would reduce ambiguity related to settlement delays in the event of liquidity shocks. Among other things, by requiring procedures that seek to avoid delay of settlement payments, this proposed rule would require covered clearing agencies to address liquidity concerns in advance rather than relying on strategies of delaying accounts payable in the event of liquidity shocks. As discussed previously, effective liquidity risk management by covered clearing agencies that serves to eliminate uncertainty on the part of clearing members that payments by the covered clearing agency will be made on time may allow these clearing members to allocate their liquidity resources to more efficient uses than holding precautionary reserves.[730] The Commission preliminarily believes the proposed rule may reduce some of the flexibility covered clearing agencies have in the absence of the proposed rule, which could impose additional burdens on these clearing agencies as discussed in Part IV.C.1.b.

Proposed Rule 17Ad-22(e)(7)(ix) would require a covered clearing agency to have policies and procedures reasonably designed to describe its process for replenishing any liquid resources that it may employ during a stress event.[731] The ability to replenish liquidity resources is critical to ensure that covered clearing agencies are able to continue operations after a stress event. Beyond the general benefits associated with liquidity risk management noted earlier, this proposed rule would yield particular benefits insofar as it would reduce uncertainty about

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730 See supra Part IV.C.2.b.

731 See proposed Rule 17Ad-22(e)(7)(ix), infra Part VII.

covered clearing agency liquidity resources at precisely those times when information about liquidity may be most important to market participants.

Finally, proposed Rule 17Ad-22(e)(7)(x) would require a covered clearing agency that provides CCP services and is either systemically important in multiple jurisdictions or is a clearing agency involved in activities with a more complex risk profile to conduct a feasibility analysis for "cover two."[732] The primary cost associated with this rule will be an annual analysis by the affected covered clearing agencies. Costs associated with a feasibility study would likely include the cost of staffing and consulting, which will depend on the scope of products cleared and the particular approach taken by each covered clearing agencies. The costs associated with this requirement are included in Part IV.C.3.d.

(5) Testing and Validation of Risk Models

Proposed Rules 17Ad-22(e)(4) through (7) include requirements for covered clearing agencies to have policies and procedures reasonably designed to test and validate models related to financial risks. Covered clearing agencies may incur additional costs under expanded and more frequent testing of financial resources if the proposed requirements for testing and validation do not conform to practices currently used by covered clearing agencies.[733] These costs are composed of two portions. The first encompasses startup costs related to collection and storage of data elements necessary to implement testing and validation, along with investments

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732 See proposed Rule 17Ad-22(e)(7)(x), infra Part VII.

733 The Commission notes that while the stress testing provisions in proposed Rules 17Ad-22(e)(4) through (7) include new requirements for covered clearing agencies, Rule 17Ad-22(b)(4) requires registered clearing agencies that provide CCP services for security-based swaps to have policies and procedures for a general margin model validation requirement. See supra note 712.

in software tools and human capital to support these functions. The second portion of costs includes the ongoing, annual costs of conducting testing and validation under the proposed rules.

Based on its supervisory experience and discussions with industry participants, the Commission preliminarily believes that startup costs to support testing and validation of credit risk, margin, and liquidity risk models at covered clearing agencies could fall in the range of $5 million to $25 million for each covered clearing agency. This range primarily reflects investments in information technology to process data already available to covered clearing agencies for stress testing and validation purposes. The range's width reflects differences in markets served by, as well as the scope of operations of, each covered clearing agency. Based on its supervisory experience and discussions with industry participants, the Commission estimates a lower bound of $1 million per year for ongoing costs related to testing of risk models.

Should each covered clearing agency choose to hire external consultants for the purposes of performing model validation required under proposed Rules 17Ad-22(e)(4) and 17Ad-22(e)(7) through written policies and procedures, the Commission preliminarily estimates the ongoing cost associated with hiring such consultants would be approximately $4,388,160 in the aggregate.[734]

The Commission acknowledges that it could have, as an alternative, proposed rules that would require testing and validation of financial risk models at covered clearing agencies at

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[734] This figure was calculated as follows: 2 Consultants for 40 hours per week at $653 per hour = $52,240 x 12 weeks = $626,880 per clearing agency x 7 covered clearing agencies = $4,388,160. The $653 per hour figure for a consultant was calculated using www.payscale.com, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

The Commission previously estimated that ongoing costs associated with hiring external consultants to fulfill the requirements of Rule 17Ad-22(b)(4) would be approximately $3.9 million per year. See Clearing Agency Standards Release, supra note 5, at 66261.

different frequencies. For example, the Commission could have required backtesting of margin resources less frequently than daily. Such a policy could imply less frequent adjustments in margin levels that may result in over- or under-margining. The Commission preliminarily believes that the frequencies of testing and validation of financial risk models that it has proposed are appropriate given the risks faced by covered clearing agencies and current market practices related to frequency of meetings of risk management committees and boards of directors at covered clearing agencies.

v. Proposed Rules 17Ad-22(e)(8) through (10): Settlement and Physical Delivery

Proposed Rules 17Ad-22(e)(8) through (10) require covered clearing agencies to have policies and procedures reasonably designed to address settlement risk. Many of the issues raised by settlement are similar to those raised by liquidity. Uncertainty in settlement may make it difficult for clearing members to fulfill their obligations to other market participants within their respective financial networks if they hold back precautionary reserves, as discussed above. Based on its supervisory experience, the Commission preliminarily believes that the benefits and costs for the majority of covered clearing agencies will likely be limited. Registered clearing agencies that enter into the set of covered clearing agencies in the future, by contrast, may bear more significant costs as a result of the enhanced standards.

Settlement finality is important to market participants for a number of reasons. Reversal of transactions can be costly to participants. For example, if transactions are reversed, buyers and sellers of securities may be exposed to additional market risk as they attempt to reestablish desired positions in cleared products. Similarly, reversal of transactions may render participants expecting to receive payment from the covered clearing agency unable to fulfill payment obligations to their counterparties, exposing these additional parties to the transmitted credit risk.

Finally, settlement finality can help facilitate default management procedures by covered clearing agencies since they improve transparency of members' positions. Unless settlement finality is established by covered clearing agencies, market participants may attempt to hedge reversal risk for themselves. This could come at the cost of efficiency if it means that, on the margin, participants are less likely to use cleared products as collateral in other financial transactions.

In addition, settlement in central bank money, where available and determined to be practical by the board of directors of the covered clearing agency, as the proposed rules would require, greatly reduces settlement risk related to payment agents. Using central bank accounts to effect settlement rather than settlement banks removes a link from the intermediation chain associated with clearance and settlement. As a result, a covered clearing agency would be less exposed to the default risk of its settlement banks. In cases where settlement banks maintain links to other covered clearing agencies, for example as liquidity providers or as members, reducing exposure to settlement bank default risk may be particularly valuable.

As in the case of proposed Rule 17Ad-22(e)(7)(iii), the Commission acknowledges there may be circumstances in which covered clearing agencies either do not have access to central bank account services or the use of such services is impractical. Accordingly, the Commission preliminarily believes it is appropriate to allow covered clearing agencies the flexibility to also use commercial bank account services to effect settlement, subject to a requirement that covered clearing agencies monitor and manage the risks associated with such arrangements.

vi. Proposed Rule 17Ad-22(e)(11): CSDs

CSDs play a key role in modern financial markets. For many issuers, many transactions in their securities involve no transfer of physical certificates.

Paperless trade generally improves transactional efficiency. Book-entry transfer of securities may facilitate conditional settlement systems required by proposed Rule 17Ad-22(e)(12). For example, book-entry transfer in a delivery versus payment system allows securities to be credited to an account immediately upon debiting the account for the payment amount. Institutions and individuals may elect to no longer hold and exchange certificates that represent their ownership of securities. An early study showed that the creation of DTC resulted in a 30–35% reduction in the physical movement of certificates.[735] Among other benefits, to the extent that delays in exchanging paper certificates result in settlement failures, immobilization and dematerialization of shares reduces the frequency of these failures.[736]

For markets to realize the transactional benefits of paperless trade, however, requires confidence that CSDs can correctly account for the number of securities in their custody and for the book entries that allocate these securities across participant accounts. In order to realize these benefits, the proposed rules also require covered CSDs to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the integrity of securities issues, minimize the risks associated with transfer of securities, and protect assets against custody risk. Based on its supervisory experience, the Commission preliminarily believes that registered CSDs already have infrastructure in place to meet these requirements. However, CSDs may face incremental compliance costs in instances where they must modify

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735 See Neal L. Wolkoff & Jason B. Werner, The History of Regulation of Clearing in the Securities and Futures Markets, and Its Impact on Competition, 30 Rev. Banking & Fin. L. 313, 323 (2010).

736 See Commission, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92nd Cong., 1st Sess. 13, at 168 (1971) (suggesting that the delivery and transfer process for paper certificates were a principal cause of failures to deliver and receive during the "paperwork crisis" of the late 1960s).

their rules in order to implement appropriate controls. Compliance costs may be higher for potential new CSDs that are determined to be covered clearing agencies in the future.

vii. Proposed Rule 17Ad-22(e)(12): Exchange-of-Value Settlement Systems

Clearance and settlement of transactions between two parties to a trade involves an exchange of one obligation for another. Regarding transactions in securities, these claims can be securities or payments for securities. A particular risk associated with transactions is principal risk, which is the risk that only one obligation is successfully transferred between counterparties. For example, in a purchase of common stock, a party faces principal risk if, despite successfully paying the counterparty for the purchase, the counterparty may fail to deliver the shares.

The proposed requirements under Rule 17Ad-22(e)(12) are substantially the same as those in Rule 17Ad-22(d)(13).[737] As a result, covered clearing agencies that have been in compliance with Rule 17Ad-22(d)(13) face no substantially new requirements under Proposed Rule 17Ad-22(e)(12). The Commission preliminary expects the proposed rule would likely impose limited material additional costs on covered clearing agencies. It would also produce benefits in line with the general economic considerations discussed in Part IV.C.1. The economic effects may differ for registered clearing agencies that enter into the set of covered clearing agencies in the future.

[737] See supra note 274; supra Part II.B.9 (discussing the full set of requirements under proposed Rule 17Ad-22(e)(13)); supra Part IV.B.3.d.ii (discussing current practices among registered clearing agencies regarding exchange-of-value settlement systems); see also 17 CFR 240.17Ad-22(d)(13).

viii. Proposed Rule 17Ad-22(e)(13): Participant-Default Rules and Procedures

Proposed Rule 17Ad-22(e)(13) would require covered clearing agencies to have policies and procedures for participant default with additional specificity relative to current requirements for registered clearing agencies under Rule 17Ad-22(d)(11). In particular, proposed Rule 17Ad-22(e)(13) requires policies and procedures that address the allocation of credit losses that exceed default resources, repayment of liquidity providers, replenishment of financial resources, and testing and review of default procedures.

Based on its supervisory experience, the Commission preliminarily believes all covered clearing agencies currently test and review default procedures at least annually, so the costs of this requirement would apply only to registered clearing agencies that may enter into the set of covered clearing agencies in the future. Most covered clearing agencies, however, will be required to update their policies and procedures as a result of proposed Rules 17Ad-22(e)(13)(i) and (ii). Clearing members may experience benefits from proposed Rule 17Ad-22(e)(13)(i), which requires covered clearing agencies to provide disclosure to members regarding the allocation of default losses when these losses exceed the level of financial resource it has available. As a result of this additional transparency, clearing members may experience an improved ability to manage their expectations of potential obligations against the covered clearing agency, which may increase the likelihood of orderly wind-downs in the event of member default. Crafting such allocation plans by covered clearing agencies may entail certain compliance costs, as previously discussed in Part III.D.5.a and as discussed further in Part IV.C.3.d. Further, covered clearing agencies may allocate default losses in a number of ways that may themselves have implications for participation, competition, and systemic risk.[738] For example, if, as a part of a default resolution plan, selective tear-up is contemplated after a failed position auction, then clearing members who expect low loss exposure in the tear-up may not have adequate incentives to participate in the position auction, even if they are better able to absorb losses than clearing members who expect high exposure in the tear-up plan. This would increase the chances of a failed auction and the chances of a protracted and more disruptive wind-down. Thus, the total costs of any loss allocation plan may depend largely on the particular choices embedded in covered clearing agencies' plans.

As an alternative to the proposed rules, the Commission could have proposed more prescriptive requirements for default procedures at covered clearing agencies. The Commission preliminarily believes that differences in cleared assets and in the characteristics of clearing members supports allowing each covered clearing agency flexibility in choosing its own default procedures pursuant to proposed Rule 17Ad-22(e)(13).

In addition to loss allocation plans, proposed Rule 17Ad-22(e)(13) contains new provisions related to the replenishment of financial resources and testing and review of default procedures that do not appear in Rule 17Ad-22(d)(11). The Commission preliminarily believes that proposed rules related to replenishment of financial resources may reduce the potential for systemic risk and contagion in cleared markets, as they facilitate covered clearing agencies' prompt access to these resources in times of financial stress. The Commission also preliminarily believes that broad-based participation in the testing of default procedures could reduce disruption to cleared markets in the event of default. However, to the extent that testing of these

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738 See, e.g., Elliot, supra note 617 (discussing various loss-allocation rules and CCP recovery and wind-down).

procedures requires participation by members of covered clearing agencies, members' customers, and other stakeholders, these parties may bear costs under the proposed rules. The Commission is unable to quantify the economic effects of participation in these tests at this time.

ix. Proposed Rule 17Ad-22(e)(14): Segregation and Portability

Segregation and portability of customer positions serves a number of useful purposes in cleared markets. In the normal course of business, the ability to efficiently identify and move an individual customer's positions and collateral between clearing members enables customers to easily terminate a relationship with one clearing member and initiate a relationship with another. This may facilitate competition between clearing members by ensuring customers are free to move their accounts from one clearing member to another based on their preferences, without being unduly limited by operational barriers.[739]

Segregation and portability may be especially important in the event of participant default. By requiring that customer collateral and positions remain segregated, covered clearing agencies can facilitate, in the event of a clearing member's insolvency, the recovery of customer collateral and the movement of customer positions to one or more other clearing members. Further, portability of customer positions may facilitate the orderly wind down of a defaulting member if customer positions may be moved to a non-defaulting member. Porting of positions in a default scenario may yield benefits for customers if the alternative is closing-out positions at one clearing member and reestablishing them at another clearing member. The latter strategy

739 See, e.g., Paul Klemperer, Competition When Consumers Have Switching Costs: An Overview with Applications to Industrial Organization, Macroeconomics, and International Trade, 62 Rev. Econ. Stud. 515 (1995) (presenting an overview of switching costs and their effects on competition).

would cause customers to bear transactions costs, which might be especially high in times of financial stress.

The Commission notes that, in its preliminary view, these proposed rules are flexible in their approach to implementing segregation and portability requirements. The most efficient means of implementing these requirements may depend on the products that a covered clearing agency clears as well as other business practices at a covered clearing agency. For example, a clearing agency's decision whether or not to collect margin on a gross or net basis may bear on its decision to port customer positions and collateral on an individual or omnibus basis, and while an individual account structure may provide a higher degree of protection from a default by another customer, it may be operationally and resource intensive for a covered clearing to implement and may reduce the efficiency of its operations.

As a result, the costs and benefits of proposed Rule 17Ad-22(e)(14) will depend on specific rules implemented by covered clearing agencies as well as how much these rules differ from current practice. Based on its supervisory experience, the Commission preliminarily believes that the current practices at covered clearing agencies to which the proposed rule would apply already meets segregation requirements under the proposed rule, so any costs and benefits for covered clearing agencies would flow from implementing portability requirements, though it potentially raises a barrier to entry for security-based swap clearing agencies or clearing agencies involved in activities with a more complex risk profile that seek to become covered clearing agencies.

x. Proposed Rule 17Ad-22(e)(15): General Business Risk

While proposed Rules 17Ad-22(e)(4) and 17Ad-22(e)(7) require that covered clearing agencies have policies and procedures reasonably designed to address credit risk and liquidity risk, proposed Rule 17Ad-22(e)(15) requires that covered clearing agencies have policies and procedures reasonably designed to address general business risk. The Commission preliminarily believes that general business losses experienced by covered clearing agencies represent a distinct risk to cleared markets, given limited competition and specialization of clearing agencies. In this regard, the loss of clearing services due to general business losses would likely result in major market disruption. The proposed rule requires a covered clearing agency to have policies and procedures reasonably designed to mitigate the risk that business losses result in the disruption of clearing services. Under these policies and procedures covered clearing agencies would hold sufficient liquid resources funded by equity to cover potential general business losses, which at a minimum would constitute six months of operating expenses. The Commission preliminarily believes that the benefits of such policies and procedures would flow primarily from covered clearing agencies that would be required to increase their holdings of liquid net assets funded by equity, enabling them to sustain their operations for sufficient time and achieve orderly wind-down if such action is eventually necessary.

The Commission could have proposed a higher or lower minimum level of resources, for example, corresponding to one quarter of operating expenses or one year of operating expenses. The Commission preliminarily believes, however, that the rules, as proposed, afford covered clearing agencies sufficient flexibility in determining the level of resources to hold while maintaining a minimum standard that supports continued operations in the event of general business losses. As another alternative, the Commission could have allowed covered clearing agencies additional flexibility in determine the nature of the financial resources held to mitigate the effects of general business risk or the means by which these resources are funded. The Commission preliminarily believes, however, that by specifying that these resources be liquid in nature, the proposed rule would limit any delays by covered clearing agencies that suffer business losses from paying expenses required for continued operations. Additionally, by specifically requiring that a covered clearing agency draw liquid net resources from members' as equity capital, the proposed rules may also encourage members to more closely monitor the business operations of a covered clearing agency, which may reduce the likelihood of losses.

Based on its supervisory experience Commission preliminarily believes that certain covered clearing agencies would be required to establish and maintain policies and procedures providing for specified levels of equity capital and higher levels of liquid net assets than they would in the absence of proposed Rule 17Ad-22(e)(15).[740] Table 2 contains summary information from five registered clearing agencies and estimates, solely for purposes of evaluating the costs and benefits of proposed Rule 17Ad-22(e)(15), the amount of additional capital these entities would be required to establish and maintain to comply with the proposed rule. As the Commission has not previously had such a capital requirement, the estimate is based on one half of the average annual operating expenses for each covered clearing agency as reflected in their annual financial statements over the five-year period ending December 31, 2012.[741]

Table 2 identifies cash and cash equivalents as liquid assets and averages this over the same five-year period. A key shortcoming of using publicly available financial data is the difficulty in determining how much of a firm's cash and cash equivalents are funded by either

740 Additional equity capital may be raised through share issuance or by retaining earnings.

741 In the case of DTCC, to obtain an estimate of annual operating expense, the Commission made minor adjustments to the total expense by excluding expenses not related to DTCC's core operations, since its annual income statement does not explicitly show the operating expense.

equity or liabilities, or both. To this end, the Commission considered two different cases.[742] In Case 1, the Commission assumed that cash on each clearing agency's balance sheet was funded by liabilities first, with the residual funded by equity. In Case 2, the Commission assumed that cash on each clearing agency's balance sheet was funded pro-rata by equity and liabilities.[743] This procedure likely yields an upper bound for estimates of additional equity necessary to meet the minimum reserve requirements.

Table 2. Hypothetical additional equity necessary to meet requirements under proposed Rule 17Ad-22(e)(15), in millions of dollars, based on years 2008–2012.[744]

	DTC	FICC	ICEEU	NSCC	OCC
Average Six Months Operating Expense	166	62	41	94	68
Average Cash and Cash Equivalents	3,151	8,259	129	3,838	64
Average Liabilities	3,364	8,471	84	3,833	155
Cash Funded by Equity	0	0	45	5	0
Average Total Equity	282	97	192	125	15
Average Net Income	21	16	119	26	2
Case 1, Additional Equity Needed	166	62	0	89	68
Case 2, Additional Equity Needed	0	0	0	0	63

742 The Commission notes that these two cases are provided as estimates of cash and cash equivalents funded by equity for existing covered clearing agencies for limited purposes of the economic analysis but are not methods the Commission would necessarily accept if used by a covered clearing agency to comply with proposed Rule 17Ad-22(e)(15). Nor should the two cases presented be viewed as interpretive guidance regarding proposed Rule 17Ad-22(e)(15).

743 For example, in Case 2, for DTC we arrive at a pro-rata allocation of cash by computing the ratio of Average Equity to the sum of Average Equity and Average Liabilities (282/3646 = 7.73%,) and applying this to Average Cash and Cash Equivalents (7.73% x 3151 = 243.71) to arrive at a proxy of the level of liquid net assets funded by equity.

744 The figures in Table 2 are based on financial data taken from the 2008–2012 annual reports of DTC, FICC, ICEEU, NSCC, and OCC. The Commission notes that these figures are presented for the limited purposes of conducting this economic analysis and do not represent methods the Commission would necessarily accept if used by a covered clearing agency to comply with proposed Rule 17Ad-22(e)(15).

Absent market frictions, a change in capital structure should have no effect on the value of a covered clearing agency.[745] The Commission acknowledges that market imperfections such as asymmetric information, moral hazard, and regulation may imply that covered clearing agencies that would need to raise additional equity capital incur opportunity costs for holding this additional capital rather than investing it in projects or distributing it back to equity holders who might, in turn, invest in projects.

To estimate these costs, the Commission applied the capital asset pricing model to observed returns for CME and ICE, two clearing agencies that have publicly-traded equity outstanding.[746] This methodology yielded an estimate of the cost of equity for these two clearing agencies of approximately 10%. Applying estimated cost of equity to the lower bound of additional equity required under the proposed rule suggests an annual cost of $16 million, while applying this cost to the upper bound of additional equity needed suggests an annual cost of $50 million.[747] These estimates are subject to a number of caveats. In particular, this exercise does

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745 See Franco Modigliani & Merton H. Miller, The Cost of Capital, Corporation Finance and the Theory of Investment, 48 Am. Econ. Rev. 261 (1958) (showing the irrelevance of capital structure in perfect markets).

746 See Eugene F. Fama & Kenneth R. French, The Cross-Section of Expected Stock Returns, 47 J. Fin. 427 (1992). For CME, the Commission used monthly return data from January 2003 to December 2012, and for ICE, from December 2005 to December 2012.

The Commission calculated this data using Daily/Monthly U.S. Stock Files © 2012 Center for Research in Security Prices (CRSP), The University of Chicago Booth School of Business, and Thomson Reuters Datastream.

747 The Commission based this estimate on the 2012 financial statements for DTC, CME, FICC, ICE, NSCC, and OCC. To ensure comparability, the Commission estimated leverage ratios for each of these clearing agencies by adjusting assets for clearing and guaranty funds and dividing by shareholders' equity. While DTC, NSCC, FICC, ICE, and CME all have estimated leverage ratios of between 1 and 2, the Commission computed a higher leverage ratio of 5 for OCC. As a result, the Commission computed OCC's cost of capital by first "unlevering" CME's estimated beta of 1.14 using 2012 financial statement information to arrive at an unlevered beta

not take into account the possibility that equity finance may reduce the cost of equity due to the resulting decrease in leverage,[748] or that clearing agencies might simultaneously raise equity while reducing liabilities. Both of these possibilities would likely reduce the cost to covered clearing agencies of increased equity capital. Finally, this analysis presumes that covered clearing agencies will choose to comply with the requirements in proposed Rule 17Ad-22(e)(15)(iii) at the lower bound of six months' operating expenses.

Clearing agencies that issue equity in order to satisfy the new requirements would additionally face costs related to issuance. The Commission preliminarily recognizes that the cost of maintaining additional equity resembles an insurance premium against the losses associated by market disruption in the absence of clearing services.

xi. Proposed Rule 17Ad-22(e)(16): Custody and Investment Risks

Proposed Rule 17Ad-22(e)(16) requires a covered clearing agency to have policies and procedures reasonably designed to safeguard both their own assets as well as the assets of participants, broadening the requirement applicable to registered clearing agencies in Rule 17Ad-22(d)(3) to the protection of participants' assets.

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of 0.87 and levering this using OCC's 2012 financial statement information to arrive at a levered beta of 3.36. Finally, the Commission applied the current Fama-French monthly risk premium at a 10-year horizon, annualized, and added the current 10 year risk-free rate to arrive at a levered cost of equity of approximately 26% for OCC.

748 See e.g., Anat R. Admati, Peter M. DeMarzo, Martin F. Hellwig & Paul Pfleiderer, Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not Expensive (Working Paper, Mar. 23, 2011), available at http://www.coll.mpg.de/pdf_dat/2010_42online.pdf (addressing the statement that "[i]ncreased bank equity requirements increase the funding costs for banks because they must use more equity, which has a higher required return").

The Commission preliminarily believes that this may have benefits in terms of protecting against systemic risk, to the extent that covered clearing agencies to this point have treated their own assets differently by applying greater safeguards to those assets than with respect to assets of their members and members' clients. Protection of member assets is important to cleared markets because, for example, the assets of a member in default serve as margin and represent liquidity supplies that a covered clearing agency may access to cover losses. If covered clearing agencies can quickly access these liquidity sources, they may be able to limit losses to non-defaulting members.

Participants may benefit from proposed Rule 17Ad-22(e)(16) in other ways. Requiring a covered clearing agency's policies and procedures to safeguard its assets and participant assets and to invest in assets with minimal credit, liquidity, and market risk may reduce uncertainty in the value of participant assets and participants' exposure to mutualized losses. This may allow participants to deploy their own capital more efficiently. Furthermore, easy access to their own capital enables members to more freely terminate their participation in covered clearing agencies.

Based on its supervisory experience, the Commission preliminarily believes that current practices at covered clearing agencies meet the requirements under proposed Rule 17Ad-22(e)(16) in most cases, so the additional costs and benefits flowing from these requirements would be generally limited to registered clearing agencies that may enter the set of covered clearing agencies in the future.

xii. Proposed Rule 17Ad-22(e)(17): Operational Risk Management

Because, as noted above, proposed Rule 17Ad-22(e)(17) would require substantially the same set of policies and procedures as Rule 17Ad-22(d)(4),[749] the Commission preliminarily believes that proposed Rule 17Ad-22(e)(17) would likely impose limited material additional costs on covered clearing agencies and produce limited benefits, in line with the general economic considerations discussed in Part IV.C.1.

xiii. Proposed Rules 17Ad-22(e)(18) through (20): Membership Requirements, Tiered Participation, and Linkages

As discussed earlier, covered clearing agencies play an important role in the markets they serve. They often enjoy a central place in financial networks that enables risk sharing, but may also enable them to serve as conduits for the transmission of risk throughout the financial system. Proposed Rules (18) through (20) require covered clearing agencies to have policies and procedures reasonably designed to explicitly consider and manage the risks associated with the particular characteristics of their network of direct members, the broader community of customers, and other parties that rely on the services provided by the covered clearing agencies or other partners that the covered clearing agency is connected to through relevant linkages. The Commission preliminarily believes that these efforts carry benefits insofar as they reduce the extent to which covered clearing agencies may impose negative externalities on financial markets.

As economies of scale contribute to the business dynamics of clearing and settlement, there is often only one clearing agency or a small number of clearing agencies for a particular

[749] See supra Part II.B.14 (discussing the full set of requirements under proposed Rule 17Ad-22(e)(17)); see also 17 CFR 240.17Ad-22(d)(4).

class of security. Consequently, membership in a clearing agency may influence competitive dynamics between members and indirect participants, such as intermediaries, in cleared markets. Members and indirect participants may compete for the same set of customers, but indirect participants must have relationships with members to access clearing services. Members, therefore, may have incentives in place to extract economic rents from indirect participants by imposing higher fees or restricting access to clearing services.

Permitting fair and open access to clearing agencies and their services may promote competition among market participants and may result in lower costs and efficient clearing and settlement services. Open access to clearing agencies may reduce the likelihood that credit and liquidity risk become concentrated among a small number of clearing members, each of which retain a large number of indirect participants through tiered arrangements. Further, links between clearing agencies may facilitate risk management across multiple security classes and improve the efficiency of collateral arrangements.

(l) Proposed Rule 17Ad-22(e)(18): Member Requirements

While fair and open access to clearing agencies may promote competition and enhance the efficiency of clearing and settlement services, these improvements should not come at the expense of prudent risk management. The soundness of clearing members contributes directly to the soundness of a clearing agency and mutualization of losses within clearing agencies expose each clearing member to the default risk of every other clearing member. Accordingly, it is important for clearing agencies to control and effectively manage the risks to which they are exposed by their direct and indirect participants by establishing risk-related requirements for participation.

Based on its supervisory experience, the Commission preliminarily believes that current practices among most covered clearing agencies involve a mix of objective financial and business requirements stipulated in publicly-available rulebooks and discretion exercised by the covered clearing agency. As a result and based on its supervisory experience, the Commission preliminarily believes that some changes to policies and procedures at covered clearing agencies may be required under the proposed rule.

(2) Proposed Rule 17Ad-22(e)(19): Tiered Participation Arrangements

The Commission preliminarily believes that proposed Rule 17Ad-22(e)(19) may improve covered clearing agencies' ability to manage its exposure to market participants that are not clearing members, but access payment, clearing, or settlement facilities through their relationships with clearing members. A covered clearing agency that is able to effectively manage its exposure to its members but fails to identify, monitor, and manage its exposures to non-member firms may overlook dependencies that are critical to the stability of cleared markets. This is particularly true if indirect participants in the covered clearing agency are large and might potentially precipitate the default of one or more direct members.

The data necessary to compute summary statistics that would be helpful in quantifying the costs and benefits of the proposed rule, including those that would indicate the size of indirect participants and the volume of transactions in which they are involved, are not available. Nevertheless, the Commission is sensitive to the fact that costs associated with the proposed rules may result in concentration of clearing services among fewer clearing members. Part of this process of consolidation may mean an increase in the volume of trading activity that involves indirect members, making identification of risks associated with indirect members even more critical. Based on its supervisory experience, however, the Commission preliminarily believes that certain covered clearing agencies already have policies and procedures in place that would satisfy the requirements of the proposed rule even in the absence of such explicit requirements under existing rules. Costs and benefits from the proposed rule would come from those other registered clearing agencies that require updates to their policies and procedures to come into compliance with the proposed rule.

The Commission is sensitive to the fact that indirect participants play a key role in maintaining competition in markets for intermediation of trading in securities insofar as they offer investors a broader choice of intermediaries to deal with in centrally cleared and settled securities markets. If elements of policies and procedures under this rule make indirect participation marginally more costly, then transactions costs for investors may increase.

(3) Proposed Rule 17Ad-22(e)(20): Links

Links between clearing agencies and their members are only one way that clearing agencies interface with the financial system. A clearing agency may also establish links with other clearing agencies and FMUs through a set of contractual and operational arrangements. For a clearing agency, the primary purpose of establishing a link would be to expand its clearing and settlement services to additional financial instruments, markets, and institutions. Established links among clearing agencies and FMUs may enable direct and indirect market participants to have access to a broader spectrum of clearing and settlement services.

Sound linkages between clearing agencies that provide CCP services may also provide their customers with more efficient collateral arrangements and cross-margining benefits. Cross-margining potentially relaxes liquidity constraints in the financial system by reducing total required margin collateral. Resources that would otherwise be posted as margin may be allocated to more productive investment opportunities.

A clearing agency that establishes a link or multiple links may also impose costs on participants in markets it clears by indirectly exposing them to systemic risk from linked entities. The Commission acknowledges that clearing agencies that form linkages may be exposed to additional risks, including credit and liquidity risks, as a consequence of these links. Links may, however, produce benefits for members to the extent that diversification and hedging across their combined portfolio reduces their margin requirements. At the same time, because such an agreement requires the linked clearing agencies to each guarantee cross-margining participants' obligations to the other clearing agency, cross-margining potentially exposes members of one clearing agency to default risk from members of the other.

By requiring that covered clearing agencies have policies and procedures reasonably designed to identify, monitor, and manage risks related to any link, proposed Rule 17Ad-22(e)(20), like Rule 17Ad-22(d)(7), reduces the likelihood that such links serve as channels for systemic risk transmission. Because proposed Rule 17Ad-22(e)(20) differs only marginally from Rule 17Ad-22(d)(7), the Commission preliminarily believes that the costs and benefits flowing from the proposed rule will be incremental, to the extent that the additional specificity in proposed Rule 17Ad-22(e)(20) causes covered clearing agencies to modify current practices. The Commission has aggregated these costs below.

xiv. Proposed Rule 17Ad-22(e)(21): Efficiency and Effectiveness

Proposed Rule 17Ad-22(e)(21) would impose on covered clearing agencies requirements in addition to those currently applied to registered clearing agencies under Rule 17Ad-22(d)(6) by also requiring covered clearing agencies to have policies and procedures that ensure that a covered clearing agency's management review efficiency and effectiveness in four key areas:

- Efficiency and effectiveness in clearing and settlement arrangements may reduce participants' transaction costs and enhance liquidity by reducing the amount of collateral that customers must provide for transactions and the opportunity cost associated with providing such collateral. Where appropriate, net settlement arrangements can reduce collateral requirements. Similarly, clearing arrangements that include a broad scope of products enable clearing members to take advantage of netting efficiencies across positions.
- Efficient and effective operating structures, including risk management policies, procedures, and systems, may reduce the likelihood of failures that may lead to impairment of a clearing agency's capacity to complete settlement and interfering with its ability to monitor and manage credit exposures.
- An efficient scope of products that a clearing agency clears, settles, or records may provide its participants and customers with more efficient collateral arrangements and cross-margining benefits that ultimately reduce transaction costs and improve liquidity in cleared markets.
- Efficient and effective use of technology and communication procedures facilitates effective payment, clearing and settlement, and recordkeeping.

The Commission preliminarily believes that requirements related to efficient operation of covered clearing agencies are appropriate given the market power enjoyed by these entities, as discussed in Part IV.C.1.d. Limited competition in the market for clearing services may blunt incentives for covered clearing agencies to cost effectively provide high quality services to market participants in the absence of regulation.

Based on its supervisory experience, the Commission preliminarily believes that some covered clearing agencies would be required to make updates to their policies and procedures as a result of the proposed rule. As a result, the Commission expects incremental costs and benefits to flow from the proposed rule only to the extent that this additional specificity causes covered clearing agencies to modify current practices.

xv. Proposed Rule 17Ad-22(e)(22): Communication Procedures and Standards

Based on its supervisory experience, the Commission preliminarily believes that some changes to policies and procedures would be necessary to meet requirements under proposed Rule 17Ad-22(e)(22).[750] These costs are included as a part of implementation costs, as discussed below. However, the Commission understands that covered clearing agencies already accommodate internationally accepted communication procedures and standards and preliminarily anticipates only incremental costs resulting from the proposed rule, in addition to the above discussed benefits. Registered clearing agencies that may enter into the set of covered clearing agencies in the future may need to conform their practices to internationally accepted communication procedures and standards, as well as adopt new policies and procedures as a result of the proposed rule, resulting in more substantial costs.

xvi. Proposed Rule 17Ad-22(e)(23): Disclosure of Rules, Key Procedures, and Market Data

Enhanced disclosure may also improve the efficiency of transactions in cleared products and improve financial stability more generally by improving the ability of members of covered clearing agencies to manage risks and assess costs. Additional information would reduce the

[750] See supra Parts II.B.19 and VII(discussing the requirements for communication procedures and standards under Rule 17Ad-22(e)(22) and providing the rule text, respectively).

potential for uncertainty on the part of clearing members regarding their obligations to covered clearing agencies. Proposed Rule 17Ad-22(e)(23) requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to require specific disclosures. As in Rules 17Ad-22(d)(9) and (11), covered clearing agencies would be required under proposed Rule 17Ad-22(e)(23) to disclose default procedures to the public and disclose sufficient information to participants to allow them to manage the risks, fees, and other material costs associated with membership.

Under proposed Rule 17Ad-22(e)(23), a covered clearing agency must establish, implement, maintain and enforce written policies and procedures reasonably designed to update, on a biannual basis, public disclosures that describe the covered clearing agency's market and activities, along with information about the agency's legal, governance, risk management, and operating frameworks, including specifically covering material changes since the last disclosure, a general background on the covered clearing agency, a rule-by-rule summary of compliance with proposed Rules 17Ad-22(e)(1) through (22), and an executive summary. The proposed rule adds a new requirement, relative to existing requirements for registered clearing agencies under Rule 17Ad-22(d)(9), to update the disclosure biannually and to include, among other things, specific data elements, including details about system design and operations, transaction values and volumes, average intraday exposure to participants, and statistics on operational reliability.

Additional transparency may have benefits for participants and cleared markets more generally. For example, if information about the systems that support a covered clearing agency is public, investors may be more certain that the market served by this agency is less prone to disruption and more accommodating of trade. Furthermore, public disclosure of detailed operating data may facilitate evaluation of each covered clearing agency's operating record by market participants. Further, under proposed Rule 17Ad-22(e)(23)(iv), these disclosures would be made about specific categories that potentially facilitate comparisons between covered clearing agencies. Additional availability of information on operations may increase the likelihood that clearing agencies compete to win market share from participants that value operational stability. This additional market discipline may provide additional incentives for covered clearing agencies to maintain reliability. Finally, updating the public disclosure every two years or more frequently following certain changes as required pursuant to proposed Rule 17Ad-22(e)(23)(v) would support the benefits of enhanced public disclosures by ensuring that information provided to the public remains up-to-date. The Commission preliminarily believes this would reduce the likelihood that market participants are forced to evaluate covered clearing agencies on the basis of stale data.

Clearing members, in particular, may benefit from additional disclosure of risk management and governance arrangements. These details potentially have significant bearing on clearing members' risk management because they may remove uncertainty surrounding members' potential obligations to a covered clearing agency. In certain circumstances, additional disclosures may reveal to members that the expected costs of membership exceed the expected benefits of membership, and that exit from the clearing agency may be privately optimal. In addition to the costs of concentration among members discussed in earlier sections, the Commission also recognizes the potential for systemic benefits from termination. Member exit on the basis of more precise information may reduce the risk posed to other financial market participants by members who, given additional information, might prefer to terminate their membership, due to an inability to manage the risks to which a covered clearing agency exposes them. While exit from clearing agencies may have consequences for competition among clearing members, the Commission preliminarily believes that encouraging the participation of firms that are not able to bear the risks of membership is not an appropriate means of mitigating the effects of market power on participants in cleared markets.

Based on its supervisory experience, the Commission preliminarily believes that some covered clearing agencies will require changes to policies and procedures as a result of the proposed rules. Compliance costs associated with changes to policies and procedures, biannual review and disclosure of additional data are included in implementation costs, below.

b. Proposed Rule 17Ab2-2

Proposed Rule 17Ad-22(e) would subject covered clearing agencies to requirements that are in many instances more specific than requirements under Rule 17Ad-22(d) and in some cases produce new obligations to establish, implement, maintain and enforce written policies and procedures reasonably designed to test, report, and disclose key elements of a covered clearing agency's performance, risk management, and operations.

Proposed Rule 17Ab2-2 provides procedures for the Commission to determine on its own initiative, or upon voluntary application by a registered clearing agency, whether a registered clearing agency is a covered clearing agency and therefore is subject to proposed Rule 17Ad-22(e). It also provides procedures for the Commission to determine whether a covered clearing agency is systemically important in multiple jurisdictions or has a complex risk profile and therefore should be subject to stricter risk management standards under proposed Rule 17Ad-22(e).

Proposed Rule 17Ab2-2(a) provides procedures for the Commission to determine whether a registered clearing agency that is otherwise not a designated clearing agency or a complex risk profile clearing agency is a covered clearing agency on the basis of the products it clears or other characteristics the Commission may deem appropriate under the circumstances.

While the Commission preliminarily believes the current scope of proposed Rule 17Ad-22(e) is appropriate,[751] proposed Rule 17Ab2-2(a) would provide the Commission with latitude in adjusting the scope of proposed Rule 17Ad-22(e) in response to financial innovation and changing economic circumstances. Proposed Rule 17Ab2-2(a) contemplates voluntary application of registered clearing agencies to become covered clearing agencies.

Proposed Rule 17Ab2-2(b) includes criteria the Commission may consider in determining whether a covered clearing agency is systemically important in multiple jurisdictions. Two of these criteria are based on input from a set of other bodies comprised of FSOC and regulators in other jurisdictions. As a result, it is possible that the flow of costs and benefits from proposed Rule 17Ad-22(e) may be partially determined by the decisions of other regulatory bodies.

Proposed Rule 17Ab2-2(c), by contrast, suggests characteristics of the financial products that a clearing agency clears as a basis upon which the Commission may determine that a clearing agency's activity has a complex risk profile.

The impact of proposed rules that determine the application of enhanced requirements could have direct costs on registered clearing agencies in the form of legal or consulting costs incurred as a result of seeking a determination from the Commission. In instances where these clearing agencies choose to apply to the Commission for status as a covered clearing agency under proposed Rule 17Ab2-2(a), the Commission preliminarily believes that a registered clearing agency's voluntary application would suggest that the applicant's private benefits from regulation under proposed Rule 17Ad-22(e) justify its costs.

Quantifiable costs related to determinations under proposed Rule a17Ab2-2 are noted in

751 See supra Part IV.C.3.a (discussing the appropriateness of the proposed scope of Rule 17Ad-22(e)).

Part IV.C.3.d.

Indirect effects of the determination process may have important economic effects on the ultimate volume of clearing activity, beyond the economic effects of the proposed requirements themselves. An important feature of proposed Rule 17Ab2-2 is providing transparency for the determinations process. On one hand, transparency may allow clearing agencies to plan for new obligations under proposed Rule 17Ad-22(e); on the other, transparency may allow clearing agencies to restructure their business to avoid falling within the scope of proposed Rule 17Ad-22(e).

To the extent that proposed Rule 17Ad-22(e), if adopted as proposed, may increase costs relative to their peers for covered clearing agencies, clearing agencies whose activities have a more complex risk profile, and clearing agencies systemically important in multiple jurisdictions, clearing agencies may have incentives to restructure their businesses strategically to avoid these Commission determinations or otherwise exit any services made prohibitively expensive by such determinations. Such potential consequential effects would be among the considerations for the Commission to review in connection with any specific decision under proposed Rule 17Ab2-2. Restructuring may involve spinning off business lines into separate entities, limiting the scope of clearing activities to certain markets, or limiting the scale of clearing activities within a single market.[752]

Any one of these responses could result in inefficiencies. As suggested in Part IV.C.2.b, registered clearing agencies may incur costs as a result of attempts to restructure. Clearing agencies that break up along product lines or fail to consolidate when consolidation is efficient

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752 See Exchange Act Release No. 34-63107 (Oct. 14, 2010), 75 FR 65881, 65919 & n.206 (Oct. 26, 2010).

may fail to take advantage of economies of scope and result in inefficient use of collateral.[753] Similarly, clearing agencies that limit their scale may provide lower levels of clearing services to the markets that they serve.

c. Proposed Rule 17Ad-22(f)

Proposed Rule 17Ad-22(f) includes a provision that specifies Commission authority over designated clearing agencies for which it is the supervisory agency. Since this provision codifies existing statutory authority, the Commission does not anticipate any economic effects from this proposed rule.

d. Quantifiable Costs and Benefits

As discussed above, the proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2 would impose certain costs on covered clearing agencies. As discussed in Part IV.C.3.a.ii, if a covered clearing agency is required to recruit new directors, the Commission preliminarily estimates a cost per director of $73,000.[754] As discussed in Part IV.C.3.a.iv(4), the Commission preliminarily estimates costs associated with liquidity resources under proposed Rules 17Ad-22(e)(7) and (a)(15) would likely fall between $133 million and $225 million per year across all covered clearing agencies. As discussed in Part IV.C.3.a.iv(5), the Commission preliminarily believes that startup costs related to financial risk management systems for existing covered clearing agencies, related to new testing and model validation requirements to be between $5 million to $25 million. The Commission also estimates a lower bound on ongoing costs related to these requirements of $1 million per year. If covered clearing agencies were to

753 See, e.g., Darrell Duffie & Haoxiang Zhu, Does a Central Clearing Counterparty Reduce Counterparty Risk?, 1 Rev. Asset Pricing Stud. 74 (2011) (addressing potential inefficiencies resulting from fragmented clearing along product lines).

754 See supra note 705.

hire external consultants for the purposes of performing model validation required under proposed Rules 17Ad-22(e)(4) and (7) through policies and procedures, the Commission preliminarily estimates the ongoing cost associated with hiring such consultants would be about $4,388,160 in the aggregate.[755] As discussed in Part IV.C.3.a.x, the Commission expects quantifiable economic costs as a result of proposed Rule 17Ad-22(e)(15) to be between $16 million and $50 million per year across covered clearing agencies.

In addition, proposed Rules 17Ad-22(e)(3), (4), (6), (7), (15) and (21) all include elements of review by either a covered clearing agency's board or its management on an ongoing basis. The Commission preliminarily estimates the cost of ongoing review for these proposed rules at approximately $39,312 per year.[756] The proposed rules would also impose certain implementation burdens and related costs on covered clearing agencies.[757] These costs generally

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755 See supra Part IV.C.3.a.iv(5), in particular note 734.

756 To monetize the cost of board review, the Commission used a recent report by Bloomberg stating that the average director works 250 hours and earns $251,000, resulting in an estimated $1000 per hour for board review. As a proxy for the cost of management review, the Commission is estimating $457 per hour, based upon the Director of Compliance cost data from the SIFMA table, see infra note 778. The Commission estimates the total cost of review for each clearing agency as follows: ((Board Review for 32 hours at $1000 per hour) + (Management Review for 16 hours at $457 per hour)) = $39,312. The Commission requests comment on this estimate.

757 To monetize the internal costs the Commission staff used data from the SIFMA publications, Management and Professional Earnings in the Security Industry—2012, and Office Salaries in the Securities Industry—2012, modified by the Commission staff to account for an 1800 hour work-year and multiplied by 5.35 (professionals) or 2.93 (office) to account for bonuses, firm size, employee benefits and overhead. Commission staff also estimated an hourly rate for a Chief Financial Officer. The website www.salary.com reports that median CFO annual salaries in 2012 were $307,554. A Grant Thornton LLP survey estimated that in 2012 public company CFOs received an average annual salary of $286,500. Using an approximate midpoint of these two estimates of $300,000 per year, and dividing by an 1800-hour work year and multiplying by the 5.35 factor which normally is used to include benefits but here is used as an approximation to offset the fact that New York salaries are typically higher than the rest of the country, the result is $892 per hour. The Commission requests comment on this estimate.

include assessment costs to determine compliance with the proposed rules and costs related to new policies and procedures and updates to existing policies and procedures required by the proposed rules. In Part III, the Commission estimated the burdens of these implementation requirements for covered clearing agencies.

For a new entrant into the set of covered clearing agencies from the set of registered clearing agencies, the Commission preliminarily estimates the startup compliance costs associated with policies and procedures to be $592,215,[758] and compliance costs associated with the determinations process under proposed Rule 17Ab2-2 to be $9,148.[759] Based on its supervisory experience, the Commission preliminarily believes that in many cases registered clearing agencies are already in compliance with many of the requirements included in the proposed rules, so this cost represents an upper bound on upfront costs. Conditioned on its current understanding of current market practice at covered clearing agencies, the Commission preliminarily estimates that the total costs across all existing covered clearing agencies will be $4,032,720.[760] The Commission preliminarily estimates that in the aggregate existing covered

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758 The total initial cost for an entrant that is not a CSD and does engage in activities with a more complex risk profile was calculated as follows: ((Assistant General Counsel for 428 hours at $467 per hour) + (Compliance Attorney for 365 hours at $310 per hour) + (Administrative Assistant for 2 hours at $72 per hour) + (Computer Operations Department Manager for 300 hours at $361 per hour) + (Senior Business Analyst for 85 hours at $245 per hour) + (Senior Risk Management Specialist for 114 hours at $249 per hour) + (Chief Compliance Office for 102 hours at $441 per hour) + (Senior Programmer for 53 hours at $282 per hour) + (Chief Financial Officer for 50 hours at $892 per hour) + (Financial Analyst for 70 hours at $245 per hour)) = $592,215.

759 The total cost associated with determinations under proposed Rule 17Ab2-2 was calculated as follows: ((Assistant General Counsel for 2 hours at $467 per hour) + (Compliance Attorney for 4 hours at $310 per hour) + (Outside Counsel for 6 hours at $400 per hour)) x 2 registered clearing agencies = $9,148.

760 The total initial cost was calculated as follows: ((Assistant General Counsel for 2,906 hours at $467 per hour) + (Compliance Attorney for 2,475 hours at $310 per hour) +

clearing agencies would be subject to ongoing costs associated with the proposed rule in the amount of approximately $801,980 per year.[761]

A benefit of the proposed rules that the Commission is able to quantify is the impact of QCCP status of OCC to non-U.S. bank clearing members at OCC. This benefit comes as a result of lower capital requirements against exposures to QCCPs relative to non-qualifying CCPs. In Part IV.C.1.e, the Commission provided an estimate of the upper bound of this benefit, $600 million per year, or 0.60% of the aggregate 2012 net income reported by bank clearing members at OCC. The Commission preliminarily believes that the actual benefits flowing from QCCP status would likely be higher due to benefits for foreign bank members of FICC and ICEEU, in addition to the benefits with respect to OCC discussed above.[762]

The Commission preliminarily believes that the proposed rules will result in an increase in financial stability insofar as they result in minimum standards at covered clearing agencies that are higher than those standards implied by current practices at covered clearing agencies. Some of this increased stability may come as a result of lower activity as the proposed rules cause participants to internalize a greater proportion of the costs that their activity imposes on the

(Administrative Assistant for 14 hours at $72 per hour) + (Computer Operations Department Manager for 2,030 hours at $361 per hour) + (Senior Business Analyst for 565 hours at $245 per hour) + (Senior Risk Management Specialist for 773 hours at $249 per hour) + (Chief Compliance Office for 699 hours at $441 per hour) + (Senior Programmer for 361 hours at $282 per hour) + (Chief Financial Officer for 350 hours at $892 per hour) + (Financial Analyst for 490 hours at $245 per hour) + (Intermediate Accountant for 15 hours at $155 per hour)) = $4,032,720.

761 The total ongoing cost was calculated as follows: ((Compliance Attorney for 1,851 hours at $310 per hour) + (Administrative Assistant for 137 hours at $72 per hour) + (Senior Business Analyst for 151 hours at $245 per hour) + (Senior Risk Management Specialist for 70 hours at $249 per hour) + (Risk Management Specialist for 1,251 hours at $131 per hour)) = $801,980.

762 See supra note 686 and accompanying text.

financial system, reducing the costs of default, conditional on a default event occurring. Increased stability may also come as a result of higher risk management standards at covered clearing agencies that effectively lower the probability that either covered clearing agencies or their members default.

The Commission preliminarily believes that clearance and settlement of securities and security-based swaps is fundamental to the stability of financial markets. As discussed above, clearing agencies may not fully consider the costs they could impose on financial market participants.[763] As a result of the potential negative externalities associated with their activities, enhanced risk management standards are particularly important for those clearing agencies that pose the greatest risk to financial markets and the U.S. financial system.

D. Request for Comments

The Commission generally requests comment about its preliminary analysis of the economic effects of the proposed rules and any qualitative and quantitative data that would facilitate an evaluation and assessment of the economic effects of this proposal. In addition, the Commission requests comment on the following specific issues:

- Has the Commission appropriately identified the relevant costs and benefits associated with each requirement under proposed Rule 17Ad-22(e)? Why or why not?

763 See Duffie, Li & Lubke, supra note 563 (noting that the failure of a CCP could suddenly expose many major market participants to losses); see also Cecchetti, Gyntelberg & Hollanders, supra note 19 ("[A] CCP concentrates counterparty and operational risks and the responsibilities for risk management. Therefore it is critical that CCPs have both effective risk control and adequate financial resources."); supra note 278 and accompanying text (asserting that delays and breakdowns in the payments and clearance process and the perception that the clearing system might not be able to meet obligations may have contributed to price declines during the October 20, 1987 market crash).

- Are there any provisions of proposed Rule 17Ad-22(e) for which the costs of enhanced risk management standards appear inappropriate relative to the benefits of such standards, particularly given existing requirements under Rule 17Ad-22(d)? Please explain.
- Would particular provisions of proposed Rule 17Ad-22(e) improve or diminish competition between covered clearing agencies? Which provisions are likely to have such effects and through what transmission channels?
- Would the scope of proposed Rule 17Ad-22(e) have implications for competition between covered clearing agencies and registered clearing agencies that are not covered clearing agencies?
- Would particular provisions of proposed Rule 17Ad-22(e) improve or diminish competition between members of covered clearing agencies? Are there any provisions that would allow a subset of members to compete on better terms than other members?
- How would the effects of QCCP status will be allocated across members? Can market participants provide any qualitative or quantitative data to help the Commission evaluate the effects of QCCP status on clearing members and any heterogeneity in trade exposures and default fund exposures to covered clearing agencies across bank and non-bank clearing members?
- Would bank clearing members to be constrained by the Basel III capital requirements? Do bank clearing members typically target tier one or total capital ratios as a business practice?
- In areas where existing requirements under Rule 17Ad-22(d) could be viewed as being consistent with the PFMI, and so could potentially earn QCCP status for covered clearing agencies, do the costs of additional requirements under proposed Rule 17Ad-22(e) appear

appropriate relative to benefits of these requirements, aside from QCCP status? Please explain.

- Does the Commission's proposed definition of qualifying liquid resources adequately reflect the ability with which covered clearing agency assets may be used to meet funding obligations? Has the Commission adequately assessed the costs and benefits of requiring funding arrangements before considering non-cash resources "qualifying"?
- What would be the potential costs and benefits of requiring covered clearing agencies to hold liquid net assets in accordance with proposed Rule 17Ad-22(e)(15)? Can you provide qualitative and quantitative data to aid the Commission in evaluating these potential costs and benefits?
- Has the Commission adequately assessed the risks posed by indirect participation at covered clearing agencies? Can you provide qualitative and quantitative data to aid the Commission in evaluating the level of indirect participation in cleared markets, the heterogeneity of indirect participation across clearing members and the implications for networks of exposures in cleared markets?

V. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA") requires the Commission, in promulgating rules, to consider the impact of those rules on small entities.[764] Section 603(a) of the Administrative Procedure Act,[765] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules to determine the impact of such rulemaking

[764] See 5 U.S.C. 601 et seq.

[765] 5 U.S.C. 603(a).

on "small entities."[766] Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule which, if adopted, would not have a significant economic impact on a substantial number of small entities.[767]

A. Registered Clearing Agencies

The proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2 would apply to covered clearing agencies, which would include registered clearing agencies that are designated clearing agencies, complex risk profile clearing agencies, or clearing agencies that otherwise have been determined to be covered clearing agencies by the Commission. For the purposes of Commission rulemaking and as applicable to the proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2, a small entity includes, when used with reference to a clearing agency, a clearing agency that (i) compared, cleared, and settled less than $500 million in securities transactions during the preceding fiscal year, (ii) had less than $200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or at any time that it has been in business, if shorter), and (iii) is not affiliated with any person (other than a natural person) that is not a small business or small organization.[768]

Based on the Commission's existing information about the clearing agencies currently registered with the Commission,[769] the Commission preliminarily believes that such entities

766 Section 601(b) of the RFA permits agencies to formulate their own definitions of "small entities." See 5 U.S.C. 601(b). The Commission has adopted definitions for the term "small entity" for the purposes of rulemaking in accordance with the RFA. These definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10.

767 See 5 U.S.C. 605(b).

768 See 17 CFR 240.0-10(d).

769 In 2012, DTCC processed $1.6 quadrillion in financial transactions, subsidiary DTC settled $110.3 trillion of securities and held securities valued at $37.2 trillion, subsidiary NSCC

exceed the thresholds defining "small entities" set out above. While other clearing agencies may emerge and seek to register as clearing agencies, the Commission preliminarily does not believe that any such entities would be "small entities" as defined in Exchange Act Rule 0-10.[770] In any case, clearing agencies can only become subject to the new requirements under proposed Rule 17Ad-22(e) should they meet the definition of a covered clearing agency, as described above. Accordingly, the Commission preliminarily believes that any such registered clearing agencies will exceed the thresholds for "small entities" set forth in Exchange Act Rule 0-10.

B. Certification

For the reasons described above, the Commission certifies that the proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2 would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission requests

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processed an average daily value of $742.7 billion in equity securities, subsidiary FICC cleared $1.116 quadrillion in government securities, and FICC's Mortgage-Backed Securities Division cleared $104 trillion of transactions in agency mortgage-backed securities. See DTCC, 2012 Annual Report, available at http://www.dtcc.com/about/annual-report.aspx and http://www.dtcc.com/annuals/2012/br-settlement-and-asset-services.html; FSOC, 2013 Annual Report, supra note 39, at 99.

In addition, OCC cleared more than 4 billion contracts and held margin of $78.8 billion at the end of 2012. See OCC, 2012 Annual Report, available at http://www.optionsclearing.com/components/docs/about/annual-reports/occ_2012_annual_report.pdf. CME Group had total contract volume of 2.89 billion contracts (in round turn trades) with a total notional value of $806 trillion. See CME Group, 2012 Annual Report, available at http://files.shareholder.com/downloads/CME/2635449816x0x653543/02DB7C7F-ACF0-4D73-9AD7-1ACCEF68559A/CME_Group_2012_Annual_Report.pdf. ICE and ICEEU together cleared CDS with a total notional value of $10.24 trillion. See Intercontinental Exchange, Inc., 2012 Annual Report, available at http://files.shareholder.com/downloads/ICE/2623237906x0x649669/DFB49A9C-152C-4287-848C-7CCDDA42D61E/ICE_2012_Annual_Report_FINAL.pdf.

770 See 17 CFR 240.0-10(d). The Commission based this determination on its review of public sources of financial information about registered clearing agencies and lifecycle event service providers for OTC derivatives.

comment regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities, including clearing agencies and counterparties to security and security-based swap transactions, and provide empirical data to support the extent of the impact.

VI. Small Business Regulatory Enforcement Fairness Act

Under the Small Business Regulatory Enforcement Fairness Act of 1996,[771] a rule is considered "major" where, if adopted, it results or is likely to result in (i) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease); (ii) a major increase in costs or prices for consumers or individual industries; or (iii) significant adverse effect on competition, investment, or innovation. The Commission requests comment on the potential impact of the proposed amendments to Rule 17Ad-22 and proposed Rule 17Ab2-2 on the economy on an annual basis, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VII. Statutory Authority and Text of Amended Rule 17Ad-22 and Proposed Rule 17Ab2-2

Pursuant to the Exchange Act, particularly Section 17A thereof, 15 U.S.C. 78q-1, and Section 805 of the Clearing Supervision Act, 12 U.S.C. 5464, the Commission proposes to amend Rule 17Ad-22 and proposes new Rule 17Ab2-2.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

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771 Pub. L. 104-121, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

Text of Amendment

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

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE

1. The general authority citation for Part 240 continues to read, and the sectional authority for § 240.17Ad-22 is revised to read, as follows:

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

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Section 240.17Ad-22 is also issued under 12 U.S.C. 5461 et seq.

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2. Amend § 240.17Ad-22 by:

a. Revising paragraphs (a) and (d) introductory text; and

b. Adding paragraphs (e) and (f).

The revisions and additions read as follows:

§ 240.17Ad-22 Standards for clearing agencies.

(a) Definitions. For purposes of this section:

(1) Backtesting means an ex-post comparison of actual outcomes with expected outcomes derived from the use of margin models.

(2) Central counterparty means a clearing agency that interposes itself between the counterparties to securities transactions, acting functionally as the buyer to every seller and the seller to every buyer.

(3) Central securities depository services means services of a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Exchange Act (15 U.S.C. 78c(a)(23)(A)).

(4) Clearing agency involved in activities with a more complex risk profile means a clearing agency registered with the Commission under Section 17A of the Exchange Act (15 U.S.C. 78q-1) and that:

(i) Provides central counterparty services for security-based swaps;

(ii) Has been determined by the Commission to be involved in activities with a more complex risk profile at the time of its initial registration; or

(iii) Is subsequently determined by the Commission to be involved in activities with a more complex risk profile pursuant to § 240.17Ab2-2(c).

(5) Conforming model validation means an evaluation of the performance of each material risk management model used by a covered clearing agency (and the related parameters and assumptions associated with such models), including initial margin models, liquidity risk models, and models used to generate clearing or guaranty fund requirements, performed by a qualified person who is free from influence from the persons responsible for the development or operation of the models or policies being validated.

(6) Conforming sensitivity analysis means a sensitivity analysis that:

(i) Considers the impact on the model of both moderate and extreme changes in a wide range of inputs, parameters, and assumptions, including correlations of price movements or returns if relevant, which reflect a variety of historical and hypothetical market conditions. Sensitivity analysis must use actual and hypothetical portfolios that reflect the characteristics of proprietary positions and, where applicable, customer positions;

(ii) When performed by or on behalf of a covered clearing agency involved in activities with a more complex risk profile, considers the most volatile relevant periods, where practical, that have been experienced by the markets served by the clearing agency; and

(iii) Tests the sensitivity of the model to stressed market conditions, including the market conditions that may ensue after the default of a member and other extreme but plausible conditions as defined in a covered clearing agency's risk policies.

(7) Covered clearing agency means a designated clearing agency, a clearing agency involved in activities with a more complex risk profile for which the Commodity Futures Trading Commission is not the Supervisory Agency as defined in Section 803(8) of the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5461 et seq.), or any clearing agency determined to be a covered clearing agency by the Commission pursuant to § 240.17Ab2-2.

(8) Designated clearing agency means a clearing agency registered with the Commission under Section 17A of the Exchange Act (15 U.S.C. 78q-1) that is designated systemically important by the Financial Stability Oversight Council pursuant to the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5461 et seq.) and for which the Commission is the supervisory agency as defined in Section 803(8) of the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5461 et seq.).

(9) Financial market utility has the same meaning as defined in Section 803(6) of the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5462(6)).

(10) Link means, for purposes of paragraph (e)(20) of this section; a set of contractual and operational arrangements between two or more clearing agencies, financial market utilities, or trading venues that connect them directly or indirectly for the purposes of participating in settlement, cross margining, expanding their services to additional instruments or participants, or for any other purposes material to their business.

(11) Net capital as used in paragraph (b)(7) of this section means net capital as defined in § 240.15c3-1 for broker-dealers or any similar risk adjusted capital calculation for all other prospective clearing members.

(12) Normal market conditions as used in paragraphs (b)(1) and (2) of this section means conditions in which the expected movement of the price of cleared securities would produce changes in a clearing agency's exposures to its participants that would be expected to breach margin requirements or other risk control mechanisms only one percent of the time.

(13) Participant family means that if a participant directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, another participant then the affiliated participants shall be collectively deemed to be a single participant family for purposes of paragraphs (b)(3), (d)(14), (e)(4), and (e)(7) of this section.

(14) Potential future exposure means the maximum exposure estimated to occur at a future point in time with an established single-tailed confidence level of at least 99% with respect to the estimated distribution of future exposure.

(15) Qualifying liquid resources means, for any covered clearing agency, the following, in each relevant currency:

(i) Cash held either at the central bank of issue or at creditworthy commercial banks;

(ii) Assets that are readily available and convertible into cash through prearranged funding arrangements without material adverse change provisions, such as:

(A) Committed arrangements, including:

(1) Lines of credit,

(2) Foreign exchange swaps, and

(3) Repurchase agreements; or

(B) Other prearranged funding arrangements determined to be highly reliable even in extreme but plausible market conditions by the board of directors of the covered clearing agency following a review conducted for this purpose not less than annually; and

(iii) Other assets that are readily available and eligible for pledging to (or conducting other appropriate forms of transactions with) a relevant central bank, if the covered clearing agency has access to routine credit at such central bank that permits said pledges or other transactions by the covered clearing agency.

(16) Security-based swap means a security-based swap as defined in Section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)).

(17) Sensitivity analysis means an analysis that involves analyzing the sensitivity of a model to its assumptions, parameters, and inputs.

(18) Stress testing means the estimation of credit or liquidity exposures that would result from the realization of extreme but plausible price changes or changes in other valuation inputs and assumptions.

(19) Systemically important in multiple jurisdictions means, with respect to a covered clearing agency, a covered clearing agency that has been determined by the Commission to be systemically important in more than one jurisdiction pursuant to § 240.17Ab2-2.

(20) Transparent means, for the purposes of paragraphs (e)(1), (2), and (10) of this section, to the extent consistent with other statutory and Commission requirements on confidentiality and disclosure, that relevant documentation is disclosed, as appropriate, to the Commission and to other relevant authorities, to clearing members and to customers of clearing members, to the owners of the covered clearing agency, and to the public.

* * * * *

(d) Each registered clearing agency that is not a covered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable:

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(e) Each covered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable:

(1) Provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.

(2) Provide for governance arrangements that:

(i) Are clear and transparent;

(ii) Clearly prioritize the safety and efficiency of the covered clearing agency;

(iii) Support the public interest requirements in Section 17A of the Exchange Act (15 U.S.C. 78q-1) applicable to clearing agencies, and the objectives of owners and participants; and

(iv) Establish that the board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities.

(3) Maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the covered clearing agency, which:

(i) Includes risk management policies, procedures, and systems designed to identify, measure, monitor, and manage the range of risks that arise in or are borne by the covered clearing agency, that are subject to review on a specified periodic basis and approved by the board of directors annually;

(ii) Includes plans for the recovery and orderly wind-down of the covered clearing agency necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses;

(iii) Provides risk management and internal audit personnel with sufficient authority, resources, independence from management, and access to the board of directors;

(iv) Provides risk management and internal audit personnel with a direct reporting line to, and oversight by, a risk management committee and an audit committee of the board of directors, respectively; and

(v) Provides for an independent audit committee.

(4) Effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by:

(i) Maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence;

(ii) To the extent not already maintained pursuant to paragraph (e)(4)(i) of this section, for a covered clearing agency providing central counterparty services that is either systemically important in multiple jurisdictions or a clearing agency involved in activities with a more complex risk profile, maintaining additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions;

(iii) To the extent not already maintained pursuant to paragraph (e)(4)(i) of this section, for a covered clearing agency not subject to paragraph (e)(4)(ii) of this section, maintaining additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the participant family that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions;

(iv) Including prefunded financial resources, excluding assessments for additional guaranty fund contributions or other resources that are not prefunded, when calculating the financial resources available to meet the standards under paragraphs (e)(4)(i) through (iii) of this section, as applicable;

(v) Maintaining the financial resources required under paragraphs (e)(4)(i) through (iii) of this section, as applicable, in combined or separately maintained clearing or guaranty funds;

(vi) Testing the sufficiency of its total financial resources available to meet the minimum financial resource requirements under paragraphs (e)(4)(i) through (iii) of this section, as applicable, by:

(A) Conducting a stress test of its total financial resources once each day using standard predetermined parameters and assumptions;

(B) Conducting a comprehensive analysis on at least a monthly basis of the existing stress testing scenarios, models, and underlying parameters and assumptions, and considering modifications to ensure they are appropriate for determining the covered clearing agency's required level of default protection in light of current and evolving market conditions;

(C) Conducting a comprehensive analysis of stress testing scenarios, models, and underlying parameters and assumptions more frequently than monthly when the products cleared or markets served display high volatility or become less liquid, and when the size or concentration of positions held by the covered clearing agency's participants increases significantly; and

(D) Reporting the results of its analyses under paragraphs (e)(4)(iv)(B) and (C) of this section to appropriate decision makers at the covered clearing agency, including but not limited to, its risk management committee or board of directors, and using these results to evaluate the adequacy of and adjust its margin methodology, model parameters, models used to generate clearing or guaranty fund requirements, and any other relevant aspects of its credit risk management framework, in supporting compliance with the minimum financial resources requirements set forth in paragraphs (e)(4)(i) through (iii) of this section; and

(vii) Performing a conforming model validation for its credit risk models to be performed not less than annually or more frequently as may be contemplated by the covered clearing agency's risk management framework established pursuant to paragraph (e)(3) of this section.

(5) Limit the assets it accepts as collateral to those with low credit, liquidity, and market risks, and set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its or its participants' credit exposure; and require a review of the sufficiency of its collateral haircuts and concentration limits to be performed not less than annually.

(6) Cover, if the covered clearing agency provides central counterparty services, its credit exposures to its participants by establishing a risk-based margin system that, at a minimum:

(i) Considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market;

(ii) Marks participant positions to market and collects margin, including variation margin or equivalent charges if relevant, at least daily and includes the authority and operational capacity to make intraday margin calls in defined circumstances;

(iii) Calculates margin sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default;

(iv) Uses reliable sources of timely price data and procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable;

(v) Uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products;

(vi) Is monitored by management on an ongoing basis and regularly reviewed, tested, and verified by:

(A) Conducting backtests of its margin resources at least once each day using standard predetermined parameters and assumptions;

(B) Conducting a conforming sensitivity analysis of its margin resources and its parameters and assumptions for backtesting on at least a monthly basis, and considering modifications to ensure the backtesting practices are appropriate for determining the adequacy of the covered clearing agency's margin resources;

(C) Conducting a conforming sensitivity analysis of its margin resources and its parameters and assumptions for backtesting more frequently than monthly during periods of time when the products cleared or markets served display high volatility or become less liquid, and when the size or concentration of positions held by the covered clearing agency's participants increases or decreases significantly; and

(D) Reporting the results of its analyses under paragraphs (e)(6)(vi)(B) and (C) of this section to appropriate decision makers at the covered clearing agency, including but not limited to, its risk management committee or board of directors, and using these results to evaluate the adequacy of and adjust its margin methodology, model parameters, and any other relevant aspects of its credit risk management framework; and

(vii) Requires a conforming model validation for the covered clearing agency's margin system and related models to be performed not less than annually, or more frequently as may be contemplated by the covered clearing agency's risk management framework established pursuant to paragraph (e)(3) of this section.

(7) Effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity by, at a minimum, doing the following:

(i) Maintaining sufficient liquid resources at the minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the participant family that would generate the largest aggregate payment obligation for the covered clearing agency in extreme but plausible market conditions;

(ii) Holding qualifying liquid resources sufficient to meet the minimum liquidity resource requirement under paragraph (e)(7)(i) of this section in each relevant currency for which the covered clearing agency has payment obligations owed to clearing members;

(iii) Using the access to accounts and services at a Federal Reserve Bank, pursuant to Section 806(a) of the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5465(a)), or other relevant central bank, when available and where determined to be practical by the board of directors of the covered clearing agency, to enhance its management of liquidity risk;

(iv) Undertaking due diligence to confirm that it has a reasonable basis to believe each of its liquidity providers, whether or not such liquidity provider is a clearing member, has:

(A) Sufficient information to understand and manage the liquidity provider's liquidity risks; and

(B) The capacity to perform as required under its commitments to provide liquidity to the covered clearing agency;

(v) Maintaining and testing with each liquidity provider, to the extent practicable, the covered clearing agency's procedures and operational capacity for accessing each type of relevant liquidity resource under paragraph (e)(7)(i) of this section at least annually;

(vi) Determining the amount and regularly testing the sufficiency of the liquid resources held for purposes of meeting the minimum liquid resource requirement under paragraph (e)(7)(i) of this section by, at a minimum:

(A) Conducting a stress test of its liquidity resources at least once each day using standard and predetermined parameters and assumptions;

(B) Conducting a comprehensive analysis on at least a monthly basis of the existing stress testing scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources, and considering modifications to ensure they are appropriate for determining the clearing agency's identified liquidity needs and resources in light of current and evolving market conditions;

(C) Conducting a comprehensive analysis of the scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources more frequently than monthly when the products cleared or markets served display high volatility, become less liquid, when the size or concentration of positions held by the clearing agency's participants increases significantly and in other appropriate circumstances described in such policies and procedures; and

(D) Reporting the results of its analyses under paragraphs (e)(6)(vii)(B) and (C) of this section to appropriate decision makers at the covered clearing agency, including but not limited to, its risk management committee or board of directors, and using these results to evaluate the adequacy of and adjust its liquidity risk management methodology, model parameters, and any other relevant aspects of its credit risk management framework;

(vii) Performing a conforming model validation of its liquidity risk models not less than annually or more frequently as may be contemplated by the covered clearing agency's risk management framework established pursuant to paragraph (e)(3) of this section;

(viii) Addressing foreseeable liquidity shortfalls that would not be covered by the covered clearing agency's liquid resources and seek to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations;

(ix) Describing the covered clearing agency's process to replenish any liquid resources that the clearing agency may employ during a stress event; and

(x) Undertaking an analysis at least once a year that evaluates the feasibility of maintaining sufficient liquid resources at a minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the two participant families that would potentially cause the largest aggregate payment obligation for the covered clearing agency in extreme but plausible market conditions if the covered clearing agency provides central counterparty services and is either systemically important in multiple jurisdictions or a clearing agency involved in activities with a more complex risk profile.

(8) Define the point at which settlement is final no later than the end of the day on which the payment or obligation is due and, where necessary or appropriate, intraday or in real time.

(9) Conduct its money settlements in central bank money, where available and determined to be practical by the board of directors of the covered clearing agency, and minimize and manage credit and liquidity risk arising from conducting its money settlements in commercial bank money if central bank money is not used by the covered clearing agency.

(10) Establish and maintain transparent written standards that state its obligations with respect to the delivery of physical instruments, and establish and maintain operational practices that identify, monitor, and manage the risks associated with such physical deliveries.

(11) When the covered clearing agency provides central securities depository services:

(i) Maintain securities in an immobilized or dematerialized form for their transfer by book entry, ensure the integrity of securities issues, and minimize and manage the risks associated with the safekeeping and transfer of securities;

(ii) Implement internal auditing and other controls to safeguard the rights of securities issuers and holders and prevent the unauthorized creation or deletion of securities, and conduct periodic and at least daily reconciliation of securities issues it maintains; and

(iii) Protect assets against custody risk through appropriate rules and procedures consistent with relevant laws, rules, and regulations in jurisdictions where it operates.

(12) Eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other, regardless of whether the covered clearing agency settles on a gross or net basis and when finality occurs if the covered clearing agency settles transactions that involve the settlement of two linked obligations.

(13) Ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, doing the following:

(i) Addressing allocation of credit losses the covered clearing agency may face if its collateral and other resources are insufficient to fully cover its credit exposures, including the repayment of any funds the covered clearing agency may borrow from liquidity providers;

(ii) Describing the covered clearing agency's process to replenish any financial resources it may use following a default or other event in which use of such resources is contemplated; and

(iii) Requiring the covered clearing agency's participants and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close-out procedures, at least annually and following material changes thereto.

(14) Enable, when the covered clearing agency provides central counterparty services for security-based swaps or engages in activities that the Commission has determined to have a more complex risk profile, the segregation and portability of positions of a participant's customers and the collateral provided to the covered clearing agency with respect to those positions and effectively protect such positions and related collateral from the default or insolvency of that participant.

(15) Identify, monitor, and manage the covered clearing agency's general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize, including by:

(i) Determining the amount of liquid net assets funded by equity based upon its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken;

(ii) Holding liquid net assets funded by equity equal to the greater of either (x) six months of the covered clearing agency's current operating expenses, or (y) the amount determined by the board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing agency, as contemplated by the plans established under paragraph (e)(3)(ii) of this section, and which:

(A) Shall be in addition to resources held to cover participant defaults or other risks covered under the credit risk standard in paragraph (b)(3) or paragraphs (e)(4)(i) through (iii) of this section, as applicable, and the liquidity risk standard in paragraphs (e)(7)(i) and (ii) of this section; and

(B) Shall be of high quality and sufficiently liquid to allow the covered clearing agency to meet its current and projected operating expenses under a range of scenarios, including in adverse market conditions; and

(iii) Maintaining a viable plan, approved by the board of directors and updated at least annually, for raising additional equity should its equity fall close to or below the amount required under paragraph (e)(15)(ii) of this section.

(16) Safeguard the covered clearing agency's own and its participants' assets, minimize the risk of loss and delay in access to these assets, and invest such assets in instruments with minimal credit, market, and liquidity risks.

(17) Manage the covered clearing agency's operational risks by:

(i) Identifying the plausible sources of operational risk, both internal and external, and mitigating their impact through the use of appropriate systems, policies, procedures, and controls;

(ii) Establishing and maintaining policies and procedures reasonably designed to ensure that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity; and

(iii) Establishing and maintaining a business continuity plan that addresses events posing a significant risk of disrupting operations.

(18) Establish objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other financial market utilities, require participants to have sufficient financial resources and robust

operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis.

(19) Identify, monitor, and manage the material risks to the covered clearing agency arising from arrangements in which firms that are indirect participants in the covered clearing agency rely on the services provided by direct participants to access the covered clearing agency's payment, clearing, or settlement facilities.

(20) Identify, monitor, and manage risks related to any link the covered clearing agency establishes with one or more other clearing agencies, financial market utilities, or trading markets.

(21) Be efficient and effective in meeting the requirements of its participants and the markets it serves, and have the covered clearing agency's management regularly review the efficiency and effectiveness of its:

(i) Clearing and settlement arrangements;

(ii) Operating structure, including risk management policies, procedures, and systems;

(iii) Scope of products cleared, settled, or recorded; and

(iv) Use of technology and communication procedures.

(22) Use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, and settlement.

(23) Maintain clear and comprehensive rules and procedures that provide for the following:

(i) Publicly disclosing all relevant rules and material procedures, including key aspects of its default rules and procedures;

(ii) Providing sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency;

(iii) Publicly disclosing relevant basic data on transaction volume and values;

(iv) Providing a comprehensive public disclosure of its material rules, policies, and procedures regarding governance arrangements and legal, financial, and operational risk management, accurate in all material respects at the time of publication, that includes:

(A) *Executive summary.* An executive summary of the key points from paragraphs (e)(23)(iv)(B), (C), and (D) of this section;

(B) *Summary of material changes since the last update of the disclosure.* A summary of the material changes since the last update of paragraph (e)(23)(iv)(C) or (D) of this section;

(C) *General background on the covered clearing agency.* A description of:

(1) The covered clearing agency's function and the markets it serves,

(2) Basic data and performance statistics on the covered clearing agency's services and operations, such as basic volume and value statistics by product type, average aggregate intraday exposures to its participants, and statistics on the covered clearing agency's operational reliability, and

(3) The covered clearing agency's general organization, legal and regulatory framework, and system design and operations; and

(D) *Standard-by-standard summary narrative.* A comprehensive narrative disclosure for each applicable standard set forth in paragraphs (e)(1) through (22) of this section with sufficient detail and context to enable a reader to understand the covered clearing agency's approach to controlling the risks and addressing the requirements in each standard; and

(v) Updating the public disclosure under paragraph (e)(23)(iv) of this section every two years, or more frequently following changes to its system or the environment in which it operates to the extent necessary to ensure statements previously provided under paragraph (e)(23)(iv) of this section remain accurate in all material respects.

(f) For purposes of enforcing the Payment, Clearing, and Settlement Supervision Act of 2010 (12 U.S.C. 5461 et seq.), a designated clearing agency for which the Commission acts as supervisory agency shall be subject to, and the Commission shall have the authority under, the provisions of paragraphs (b) through (n) of Section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) in the same manner and to the same extent as if such designated clearing agency were an insured depository institution and the Commission were the appropriate Federal banking agency for such insured depository institution.

* * * * *

3. Section 240.17Ab2-2 is added to read as follows:

§ 240.17Ab2-2 Determinations affecting covered clearing agencies.

(a) The Commission may, if it deems appropriate, upon application by any clearing agency or member of a clearing agency, or on its own initiative, determine whether a registered clearing agency should be considered a covered clearing agency. In determining whether a clearing agency should be considered a covered clearing agency, the Commission may consider:

(1) Characteristics such as the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults; or

(2) Such other characteristics as it deems appropriate in the circumstances.

(b) The Commission may, if it deems appropriate, upon application by any clearing agency or member of a clearing agency, or on its own initiative, determine whether a covered clearing agency is systemically important in multiple jurisdictions. In determining whether a covered clearing agency is systemically important in multiple jurisdictions, the Commission may consider:

(1) Whether the covered clearing agency is a designated clearing agency;

(2) Whether the clearing agency has been determined to be systemically important by one or more jurisdictions other than the United States through a process that includes consideration of whether the foreseeable effects of a failure or disruption of the designated clearing agency could threaten the stability of each relevant jurisdiction's financial system; or

(3) Such other factors as it may deem appropriate in the circumstances.

(c) The Commission may, if it deems appropriate, determine whether any of the activities of a clearing agency providing central counterparty services, in addition to clearing agencies registered with the Commission for the purpose of clearing security-based swaps, have a more complex risk profile. In determining whether a clearing agency's activity has a more complex risk profile, the Commission may consider:

(1) Characteristics such as the clearing of financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults; or

(2) Such other characteristics as it deems appropriate in the circumstances, as factors supporting a finding of a more complex risk profile.

(d) The Commission shall publish notice of its intention to consider making a determination under paragraph (a), (b), or (c) of this section, together with a brief statement of the grounds under consideration therefor, and provide at least a 30-day public comment period prior to any such determination, giving all interested persons an opportunity to submit written data, views, and arguments concerning such proposed determination. The Commission may provide the clearing agency subject to the proposed determination opportunity for hearing regarding the proposed determination.

(e) Notice of determinations under paragraph (a), (b), or (c) of this section shall be given by prompt publication thereof, together with a statement of written reasons therefor.

(f) For purposes of this rule, the terms central counterparty, covered clearing agency, designated clearing agency, and systemically important in multiple jurisdictions shall have the meanings set forth in § 240.17Ad-22(a).

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Date: March 12, 2014.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71694 / March 12, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3790 / March 12, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15784

In the Matter of GEORGE LOUIS THEODULE, 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 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") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against George Louis Theodule ("Respondent" or "Theodule").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From July 2007 through December 2008, Theodule was the president and sole officer and director of Creative Capital Consortium, LLC, and also managed A Creative Capital Concept$, LLC (collectively "Creative Capital"), two now defunct entities he used to raise investor funds. Neither entity was ever registered with the Commission. Theodule, 52, a former resident of Loganville, Georgia, is currently incarcerated at the Miami Federal Detention Center in Miami, Florida.

B. ENTRY OF THE RESPONDENT'S CRIMINAL CONVICTION

2. On October 28, 2013, Theodule pleaded guilty to one count of Wire Fraud in violation of Title 18 United States Code, Section 1343 before the United States District Court for the Southern District of Florida, in United States v. George Louis Theodule, Case No. 9:13-CR-80141. On February 24, 2014, the Court sentenced Theodule to 12.5 years in prison and three years of supervised release, with restitution to be set at a later date.

3. The count of the criminal indictment to which Theodule pleaded guilty alleged, among other things, that beginning in about July 2007 and continuing through December 2008 Theodule knowingly and willfully devised and intended to devise a scheme and artifice to defraud others and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, and that he knowingly transmitted and caused to be transmitted wire transfers of funds in furtherance of a scheme to defraud.

4. In his plea, Theodule admitted that:

- In July 2007, he began falsely holding himself out as a "financial wizard" in the South Florida Haitian community, who, through proven investment strategies, could double investors' principal in 30 to 90 days. He formed approximately 100 investment clubs with more than 2500 members who invested from $1,000 to $100,000.

- From 2007 to 2008, Theodule raised more than $30 million from investors, and deposited approximately $19 million in trading accounts. None of these accounts were profitable, and Theodule quickly lost the funds invested and used a substantial amount of investors' funds for his personal benefit and the benefit of family members and friends.

- Despite these losses, Theodule continued to recruit new investors through late 2008 while promising he would earn substantial returns. He also assured investors that their money was safe and earning profits while he operated a Ponzi scheme, eventually running out of funds to pay returns, leading to the scheme's collapse.

5. The facts in the plea agreement also formed the basis of a Commission 2008 civil action against Theodule and his entities entitled Securities and Exchange Commission v. Creative Capital, et al., Civil Action No. 08-CIV-81565, in the United States District Court for the Southern District of Florida. On March 26, 2010, the Court entered a final Judgment of Disgorgement, Prejudgment Interest and Civil Penalty against Theodule ordering him to pay disgorgement in the amount of $5,099,512, prejudgment interest of $202,638 and a civil penalty of $250,000.

6. During the time of the scheme giving rise to the criminal and civil actions, Theodule, as sole officer and president of Creative Capital, solicited investor contributions, touted his stock trading strategy, made investment decisions on behalf of clients, controlled clients' trading accounts through agreements with the investment clubs that authorized him to trade in securities and act on behalf of each member of the clubs, transacted business with independent

investment clubs, received transaction-based compensation in the form of commissions, and he also misappropriated investor funds. Theodule and his companies charged investors a 10% upfront fee and a 40% commission on any profits obtained.

III.

In view of Respondent's criminal conviction, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and,

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

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

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 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.

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9560 / March 13, 2014

Admin. Proc. File No. 3-15658

In the Matter of Multri-Precision, LLC 115 Main Street Oakville, CT 06779	ORDER DISMISSING ADMINISTRATIVE PROCEEDINGS

On December 20, 2013, pursuant to Section 8(d) of the Securities Act of 1933,[1] the Commission instituted an administrative proceeding against Multri-Precision, LLC. Section 8(d) provides, in relevant part, that "if it appears to the Commission that a registration statement filed with the Commission includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, the Commission may... issue a stop order suspending the effectiveness of the registration statement."

The Division of Enforcement alleged that the registration statement filed by Multri-Precision failed to provide certain items which are required by Commission forms and regulations governing the offer and sale of securities to the public. Given these allegations, the Division sought a Stop Order suspending the effectiveness of the registration statement.

On December 31, 2013, Multri-Precision requested the withdrawal of its registration statement, pursuant to Securities Act Rule 477.[2] Rule 477 states that an application to withdraw a registration statement is deemed granted at the time of filing, unless the Commission notifies the applicant that the request will not be granted within 15 calendar days of filing. On January 15, 2014, the Division of Corporation Finance, by delegated authority, consented to Multri-Precision's request to withdraw the registration statement, and so the registration statement was

[1] 15 U.S.C. § 77h(d).
[2] 17 C.F.R. § 230.477.

withdrawn. On February 19, 2014, the Division of Enforcement filed a motion to dismiss the proceeding against Multri-Precision, based on the withdrawal of Multri-Precision's registration statement. Multri-Precision previously confirmed it had no objection to the Division's motion. Therefore, based on all of the above, it is appropriate to grant the Division's motion.

Accordingly, IT IS ORDERED that the Division of Enforcement's motion to dismiss the administrative proceeding against Multri-Precision, LLC is hereby GRANTED and the proceeding is dismissed without prejudice.

By the Commission.

Lynn Powalski
Deputy Secretary

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71711 / March 13, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15786

In the Matter of	
FREEDOM ENVIRONMENTAL SERVICES, INC.	**ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES**
Respondent.	

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Freedom Environmental Services, Inc. ("Freedom" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

A. Freedom (trading symbol FRDM), a Delaware corporation based in Orlando, Florida, provides wastewater management and recycling services, and commercial and residential septic services. The common stock of Freedom has been registered under Section 12(g) of the Exchange Act since October 2008. It was quoted on the "Pink Sheets" disseminated by Pink Sheets LLC until September 17, 2012, when the Commission issued an Order of Suspension of Trading pursuant to Section 12(k) of the Exchange Act. Since the trading suspension expired, there has been only sporadic trading of Freedom common stock in the grey market.

B. Freedom has failed to comply with Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder, while its common stock was registered with the Commission in that it (1) has filed false Annual Reports on Form 10-K on June 7, 2011, and May 16, 2012; (2) filed false quarterly reports on Form 10-Q for the quarters ended March 31, 2011, June 30, 2011, September 30, 2011, March 31, 2012, and June 30, 2012; (3) filed false press releases on Forms 8-K and has not filed any Form 8-K[2] disclosing the filing of its bankruptcy petition on, August 13, 2012 or the filing of the Commission's civil action against Freedom on September 17, 2012; and (4) has failed to file Forms 10-Q for the quarters ended September 30, 2012, March 31, 2013, June 30, 2013, and September 30, 2013, and has failed to file its Form 10-K for the fiscal year ended December 31, 2012.

IV.

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

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

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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] Freedom filed false press releases on Nov. 11, 2010; Nov. 17, 2010; March 5, 2011; Feb. 24, 2012; May 15, 2012; and July 17, 2012.

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9559 / March 13, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71715 / March 13, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3794 / March 13, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 30981 / March 13, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15790

In the Matter of MICHAEL A. HOROWITZ and MOSHE MARC COHEN, 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 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY 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 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Michael A. Horowitz ("Horowitz") and Moshe Marc Cohen ("Cohen") (collectively, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

1. These proceedings arise from a fraudulent scheme to profit from the imminent deaths of terminally ill hospice and nursing home patients through the purchase and sale of more than $80 million in deferred variable annuities ("variable annuities") between July 2007 and at least February 2008.

2. The scheme was orchestrated by Respondent Horowitz, then a registered representative of a large broker-dealer firm ("Broker-Dealer 1"). Horowitz, together with others, made material misrepresentations and used deceptive devices to obtain the personal health and identifying information ("ID and Health Data") of terminally ill hospice and nursing home patients in order to designate them as annuitants on variable annuity contracts that Horowitz marketed to wealthy investors. Horowitz marketed these variable annuities – which are designed by their issuers to be long-term investment vehicles – as opportunities for short-term gains with a hedge against market losses. Horowitz recruited Respondent Cohen to facilitate the sale of additional "stranger-owned" annuities and they each obtained their firms' approval of variable annuity sales by making material misrepresentations and omissions on trade tickets, customer account forms and/or point-of-sale forms, which the broker-dealer principals used to conduct investment suitability and related reviews. As a result of the Respondents' fraudulent acts and practices, certain insurance companies unwittingly issued variable annuities that they would not otherwise have sold. The annuities sold during the scheme – which included five annuities sold to Horowitz's close relatives for profits in excess of $900,000 – generated lucrative upfront sales commissions for the Respondents, with Horowitz receiving more than $300,000 and Cohen receiving more than $700,000 in commissions.

3. By virtue of the foregoing conduct and as alleged further herein, Respondents, directly or indirectly, singly or in concert, have engaged in acts, practices, schemes and courses of business that violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Respondents Horowitz and Cohen also violated Sections 17(a)(1) and (2) of the Securities Act, and aided and abetted and caused violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder. In addition, Respondent Horowitz violated Section 15(a) of the Exchange Act.

RESPONDENTS

4. **Michael A. Horowitz**, age 39, the scheme architect, resides in Los Angeles, California. Horowitz is currently a registered representative of an SEC-registered broker-dealer. Horowitz also manages Monarch Capital, Inc., an investment adviser formerly registered with the SEC. Between June 2000 and August 2008, Horowitz was a registered representative at Broker-Dealer 1. He resigned during Broker-Dealer 1's investigation into his sale of the variable annuities at issue. Horowitz holds Series 7 and 66 licenses.

5. **Moshe Marc Cohen**, age 38, was a registered representative recruited to the scheme by Horowitz, and resides in Brooklyn, New York. He is not currently associated with any SEC-registered entity. From 2003 to February 2008, Cohen was a registered representative at Broker-Dealer 3. Broker-Dealer 3 terminated Cohen's employment on February 25, 2008 after he refused to cooperate with Broker-Dealer 3's internal review of Cohen's variable annuity sales at issue. Cohen held Series 6, 7, 24 and 63 licenses.

OTHER RELEVANT ENTITIES

6. **Broker-Dealer 1** is a broker-dealer and investment adviser registered with the Commission and headquartered in New York, New York.

7. **Broker-Dealer 2** is a broker-dealer and investment adviser registered with the Commission and headquartered in New York, New York.

8. **Broker-Dealer 3** is a broker-dealer and investment adviser registered with the Commission and headquartered in Oakdale, Minnesota.

9. **Charity 2** was established by "Annuitant Finder 1" in or about June 2007, as a registered d/b/a of an existing non-profit 501(c)(3) organization. Also in or about June 2007, Annuitant Finder 1 set up a web page for Charity 2, which described Charity 2 as an organization "dedicated to helping patients with a life limiting illness to live their remainder days in comfort and dignity." In fact, the purpose of Charity 2 was to obtain ID and Health Data of terminally ill patients for use in the purchase and sale of variable annuities.

THE RESPONDENTS' SCHEME

Variable Annuities

10. Variable annuities are designed to serve as long-term investment vehicles, typically to provide income at retirement. Although variable annuities offer investment features similar in many respects to mutual funds, a typical variable annuity offers certain features not commonly found in mutual funds, including death benefits[1] and/or bonus

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1 The typical variable annuity death benefit provides for a payment to the beneficiary at the contract annuitant's death equal to either the value of the underlying investment portfolio or the purchase price of the annuity less any withdrawals, whichever is greater. This death benefit option allows an investor to profit from positive investment performance as part of the death benefit while providing a hedge against losses in the portfolio's value by providing for a payout equal to at least the amount invested in the annuity less any withdrawals. In the typical variable annuity, the contract owner is also the contract "annuitant." However, in the scheme described herein, hospice and nursing home patients unrelated to the contract owners were designated as the annuitants.

credits.[2] Horowitz solicited wealthy individual and institutional investors to make large investments in variable annuities that offered these benefits.

Horowitz's "Stranger-Owned" Variable Annuities Investment Strategy

11. In or about May 2007, Respondent Horowitz devised the scheme that is the subject of this proceeding after learning about the features of certain variable annuity contracts offered by an annuity issuer ("VA Issuer").

12. In particular, Horowitz learned that, unlike traditional life insurance, these variable annuity contracts—as long as they were purchased under a certain dollar threshold—required neither a physical examination of, nor proof of an "insurable interest" in, the "annuitant," *i.e.*, the person whose death would trigger the products' payout provisions. Horowitz further determined that with respect to certain of the VA Issuer's deferred variable annuity products: (i) the VA Issuer provided an immediate "bonus credit" of up to 5% of the amount invested, which was credited to the contract owner's investment account; (ii) the contract owner could invest his or her premiums in mutual funds available under the contract; (iii) the annuities contained death benefit options; (iv) although substantial "surrender charges" were ordinarily assessed if the annuities were liquidated within the first 7-10 years, such charges were typically not incurred in the event of a death benefit payout; and (v) even if the annuitant died before the "surrender charge" period had run, the VA Issuer would not "claw back" any of the sales commissions it paid to the selling representative.

13. Horowitz developed a strategy to exploit these benefits by using terminally ill hospice and nursing home patients as the contract annuitants and soliciting wealthy individual and institutional investors to make large investments in variable annuities that offered these benefits.

14. In each of these contracts, a terminally ill hospice or nursing home patient was designated as the contract annuitant. At least 16 terminally ill hospice patients were designated as annuitants in more than 50 variable annuities sold by Horowitz, Cohen, or other registered representatives recruited to the scheme. All of the hospice patients were residents of southern California or Chicago, Illinois.

15. The hospice patients designated as annuitants had no familial or business relationship with the investors who purchased the annuities. Instead, they were selected based on their terminal illnesses and the likelihood that they would die soon, and thereby trigger death benefit payouts in variable annuity contracts in the very near term. As part of his pitch to investors, Horowitz told them that he would supply the annuitants, with investors needing to furnish only their funds.

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[2] A bonus credit is a sum of money immediately credited to the contract owner's investment account by the annuity issuer (typically a percentage of the premiums being invested in the annuity contract). For example, certain investors that purchased variable annuities through Horowitz made an initial investment of $1 million and received "bonus credits" that increased the value of their annuity by 5% ($50,000) to $1,050,000.

16. These "stranger annuitants" likewise had no contractual right to any portion of the death benefits paid out under the terms of the variable annuities sold during the scheme. Instead, each of the contracts directed these benefits be paid to one of the investor's family members or relatives, or to a family trust created by the investor.

17. Anticipating that the annuitants would soon die, triggering death benefit payouts in the annuity contracts, Horowitz advised his customers to invest their premiums aggressively because if the value of their portfolio increased, they would receive the portfolio value as the death benefit payout. If the value of their portfolio decreased, the death benefit nonetheless guaranteed them a payout equal to the value of their premiums paid minus any withdrawals. Horowitz also advised his customers to invest large sums of money in each annuity they purchased to maximize their "bonus credit."

18. Horowitz employed at least two varieties of fraud in carrying out his sale of "stranger-owned" annuities. First, Horowitz and others fraudulently obtained and used the ID and Health Data of certain unwitting terminally ill hospice and nursing home patients who were designated as annuitants. Second, Horowitz and Cohen falsified broker-dealer trade tickets, customer account forms and/or point-of-sale forms (including suitability questionnaires) to obtain supervisory approval of the annuities that were sold pursuant to the scheme. As a result of these fraudulent acts and practices, certain insurance companies, including VA Issuer, unwittingly issued variable annuities that they would not otherwise have sold.

Horowitz Obtains Confidential ID and Health Data through Deceptive Practices

19. To implement his plan, Horowitz needed a ready supply of terminally ill persons, unrelated to the investors, to use as annuitants in variable annuity sales. Horowitz recruited certain individuals ("Annuitant Finders") to identify the terminally ill persons to be used as annuitants. Working with Horowitz, these Annuitant Finders engaged in a scheme to obtain the patients' confidential ID and Health Data, which they then fraudulently misused. Horowitz needed patients' Health Data to confirm that the individuals he designated as annuitants had a terminal medical diagnosis. He needed their ID Data (including social security number and date of birth) to designate them as annuitants and to submit death benefit claims to the issuers whose annuities he sold.

<u>The California Annuitants</u>

20. In May 2007, Horowitz approached Annuitant Finder 1and described his stranger-owned annuities scheme to him. Because Annuitant Finder 1 worked at a non-profit 501(c)(3) organization ("Charity"), Horowitz asked Annuitant Finder 1 to assist him with identifying terminally ill patients and obtaining their confidential ID Data.

21. After a series of closed-door meetings between Horowitz and Annuitant Finder 1 at Charity's offices in May 2007, Annuitant Finder 1 told his assistant that he was

going to start a new charity, Charity 2. Charity 2 was purportedly going to focus on providing charitable assistance exclusively to hospice care patients.

22. Charity 2 was used in the scheme to obtain patient ID and Health Data. On June 1, 2007, Annuitant Finder 1 filed a fictitious name certificate with the State of California, allowing one of his existing charities to do business under Charity 2's name.

23. Annuitant Finder 1 created a website for Charity 2 and set up Charity 2 email accounts. The Charity 2 webpage stated that Charity 2 was:

> an organization dedicated to helping patients with a life limiting illness to live their remainder days in comfort and dignity.... Through the generosity of private and corporate philanthropists [Charity 2] helps patients who[] have chosen hospice care and are at home or in a facility....

24. In reality, Charity 2 had no private or corporate donors, and its true purpose was to obtain patient ID and Health Data for Horowitz's use in selling stranger-owned annuities. Charity 2's website failed to disclose these facts.

25. In July 2007, Annuitant Finder 1 opened a bank account in the name of Charity 2, and funded it with several thousand dollars from his personal bank account. These funds were to be used for the charitable donations Annuitant Finder 1 planned to offer hospice patients as part of the plan to obtain their ID and Health Data.

26. Beginning in June 2007, Annuitant Finder 1 held Charity 2 out as a charity devoted to providing assistance to hospice patients. Annuitant Finder 1 solicited hospice care providers in Los Angeles, San Francisco and New Orleans by touting Charity 2's purported charitable services. In contemporaneous emails to those hospice care providers, Annuitant Finder 1 and his assistant described Charity 2 as a "non-profit 501(c)(3) organization."

27. In June 2007, Annuitant Finder 1 met with the Director of Development of a southern California hospice care provider ("HCP"). During the June 2007 meeting, Annuitant Finder 1 told HCP's Director of Development that Charity 2

> was an organization of some large, very high profile donors, the type of donors whose names are often on the sides of buildings at Universities, that sort of donor, Universities, hospitals. And that in this instance, they wanted to give and remain anonymous in that gift so that they had established [Charity 2]....[Annuitant Finder 1] indicated that they would like to see the patient, they would like to meet the patient. He, specifically. [*sic*] And the purpose for that was that they could tell – he could tell their donors or his donors who those individuals were that they were actually meeting – so he would be able to tell a story to help receive other donations to

> continue those donations to come into the individual patient requests that they were filling.

28. Annuitant Finder 1's statements to HCP's Director of Development were false because, among other reasons, Charity 2 had no donors other than Annuitant Finder 1.

29. Annuitant Finder 1 implied that there were conditions on the purported aid to be offered. First, only HCP hospice patients (*i.e.*, those who had been diagnosed with terminal illnesses and were receiving only palliative care in their home), as opposed to other HCP patients receiving in-home curative care or treatment, were eligible for Charity 2's donations. Second, Annuitant Finder 1 capped the amount to be donated per patient at between $250-$500. Third, Charity 2 required that HCP provide it with the following information concerning any candidate for a donation: (i) the patient's name and address; (ii) the patient's date of birth; (iii) the patient's social security number; (iv) the patient's medical diagnosis; and (v) confirmation that the patient was receiving hospice care. This was the information that Respondent Horowitz needed to designate the hospice patients as annuitants. Finally, Annuitant Finder 1 conditioned the donations on his right to visit the HCP patient in question. Annuitant Finder 1 told HCP that he wanted to be able to tell his donors each patient's "story" to help raise additional donations for other patients. After visiting Charity 2's website to confirm the legitimacy of the charity, the HCP administrator—grateful for what he understood to be Charity 2's purely charitable donations to HCP's hospice patients—agreed to Annuitant Finder 1's conditions.

30. Annuitant Finder 1 never told HCP that he planned to forward patient personal identifying information to Horowitz, or that Horowitz intended to sell annuity contracts to third parties who would profit when HCP patients died.

31. Between late July 2007 and at least December 2007, Annuitant Finder 1 met with multiple HCP hospice patients and with certain patients receiving care from other hospice providers. These meetings took place at the patients' homes. Horowitz attended many of these meetings.

32. Social workers from HCP also attended the meetings with HCP hospice patients. Annuitant Finder 1 told HCP social workers that he wanted to meet with the patients who were receiving charitable assistance from Charity 2 so he could tell their story to Charity 2's "donors." According to one HCP social worker

> When – at the meeting when we met with the patient in their home, before we met, they, [Annuitant Finder 1] and [Horowitz], met me and stated that the patients – the donors for this money did not want to give to hospitals. They didn't want to give to big organizations, that they would just receive a nameplate.
>
> They wanted to see where their money was being spent; so therefore, [Annuitant Finder 1] and [Horowitz] showed up. They had a box of candy for the patient.

Horowitz was present when Annuitant Finder 1 made these statements to the HCP social worker and knew them to be false. Horowitz did not, however, clarify or correct them in any way.

33. The patients, their families and their HCP health care providers all believed that the purpose of the visits was charitable. However, Horowitz's true purpose in visiting patients was to confirm that they were in fact dying, and, therefore, that they were suitable annuitants. Horowitz actively concealed his true purpose for attending from HCP and the hospice patients they visited, telling one HCP social worker that he represented persons "who were going to be making donations." This statement was materially false because Horowitz did not represent any donors and in fact there were never any donors to Charity 2, other than Annuitant Finder 1. Horowitz's statement was also materially misleading because he omitted the true purpose for his visit.

34. Unbeknownst to HCP and its patients, after each patient meeting, Annuitant Finder 1 provided Horowitz with the ID and Health Data that he obtained from HCP under false pretenses. Horowitz arranged for Annuitant Finder 1 to send the patient ID and Health Data to Horowitz's personal email account. Horowitz then used the patient ID and Health Data to sell variable annuities in which the hospice patients were designated as the contract annuitants.

35. Between July 2007 and at least December 2007, Annuitant Finder 1 provided Horowitz with the ID and Health Data of hospice patients in southern California. At least six of these patients were designated as annuitants in at least 18 variable annuities sold by Horowitz and a second representative whom Horowitz recruited to the scheme, with some of the patients designated as annuitants in multiple policies. Horowitz paid Annuitant Finder 1 at least $130,000 for his services to the scheme.

36. As part of the ruse, Annuitant Finder 1 asked HCP to keep him informed of the health status of each patient whom he had visited, falsely telling HCP that Charity 2's "donors" wanted to remain apprised of each patient's story. In reality, Horowitz and Annuitant Finder 1 wanted this information so they would know when each patient died so that Horowitz could timely file annuity death benefit claims for his customers, who then stood to receive payouts on their variable annuity investments. As part of the scheme, Annuitant Finder 1 obtained death certificates for each of the patients who had been designated as an annuitant and provided the death certificates to Horowitz for his use in filing death benefit claims.

37. HCP, its hospice patients, and their families were completely unaware that Horowitz had sold variable annuities on the lives of HCP hospice patients and that third parties stood to profit from their deaths.

38. HCP would not have released patient ID and Health Data to Annuitant Finder 1 or allowed Horowitz and Annuitant Finder 1 to meet with its patients if it had been aware of the true purpose of Charity 2 and of Horowitz's scheme. Similarly, the patients

and their caregivers would not have allowed Horowitz and Annuitant Finder 1 to meet with them had they known the true purpose of Charity 2 and of Horowitz's scheme.

Horowitz Travels to Chicago to Recruit Additional Annuitant Finders

39. In Fall 2007, Horowitz decided to grow his variable annuity business by expanding the pool of terminally ill individuals available to be designated as annuitants. He travelled to Chicago, Illinois in October 2007, and met with Annuitant Finder 2, an executive officer of a privately held company that owned and operated nursing homes in the Chicago area.

40. Horowitz agreed to pay Annuitant Finder 2 in exchange for his identification of hospice patients and in exchange for supplying Horowitz with the ID & Health Data of terminally ill individuals in the Chicago area. Annuitant Finder 2 recruited an associate, Annuitant Finder 3, to assist him in identifying terminally ill patients. As part of their arrangement, Annuitant Finders 2 and 3 agreed to keep Horowitz and his associates apprised of the health status of the patient-annuitants, and Annuitant Finder 2 provided Horowitz and his associates with death certificates when the patients died.

41. Between November 2007 and February 2008, Annuitant Finders 2 and 3 supplied Horowitz, or his associates, with the names and ID and Health Data of at least 10 terminally ill patients in Chicago. These patients were designated as annuitants in at least 7 variable annuities sold through Broker-Dealer 2, and in at least 28 variable annuities sold by Respondent Cohen. Horowitz paid Annuitant Finder 2 at least $150,000 for his and Annuitant Finder 3's services to the scheme.

Fraud in the Execution of Broker-Dealer Trade Tickets and Point-of-Sale Forms

Horowitz Falsifies his Broker-Dealer 1 Trade Tickets

42. Between July 2007 and October 2007, Horowitz sold at least 14 deferred bonus variable annuities to his customers through his registration with Broker-Dealer 1.

43. For each of these 14 annuities, Horowitz designated a terminally ill hospice patient as the contract annuitant and used the patient ID and Health Data that he and Annuitant Finder 1 had fraudulently obtained from hospice care providers, through Charity 2 or directly from patients or their family caregivers. By designating patients with terminal medical diagnoses as the contract annuitants, Horowitz sought to guarantee that his customers would receive death benefit payouts within months of the annuities sales. For his part, Horowitz stood to receive lucrative upfront commissions on each stranger-owned annuity he sold.

44. Horowitz marketed his stranger-owned annuities investment strategy to customers as an opportunity for obtaining short-term investment gains with a hedge against investment losses, and Horowitz's customers intended to use the variable annuities

as short-term investment vehicles. However, Horowitz also knew that, in the event the "stranger annuitants" did not die within a matter of months, his customers would be locked into unsuitable, highly illiquid long-term investment vehicles that they would be unable to exit without paying substantial surrender charges.

45. To ensure that its registered representatives were selling suitable investments to their customers, and to ensure that the investment was being used for its intended purpose, Broker-Dealer 1 required its principals to review and approve each proposed sale of an annuity. As part of this process, Broker-Dealer 1 mandated that Horowitz complete an electronic trade ticket, including a suitability questionnaire, for every variable annuity that he sold. A Broker-Dealer 1 principal reviewed each trade ticket. Variable annuity applications could be submitted to the issuing insurance company only after principal approval of the ticket.

46. Each trade ticket required Horowitz to state how long the customer intended to hold the variable annuity being purchased. As part of the review process, Broker-Dealer 1's principals closely scrutinized the response to this question to ensure, among other things, that the customer intended to hold the investment for a period of time exceeding the surrender charge period in the deferred variable annuity contract being purchased. The 14 annuities that Horowitz sold through Broker-Dealer 1 had a nine year surrender charge period.

47. Knowing that his stranger-owned annuities sales would be rejected by Broker-Dealer 1's reviewing principals if he provided truthful timing information concerning his customers' intention to use the annuities as short-term investment vehicles, Horowitz submitted trade tickets falsely stating that his customers intended to hold their annuities from anywhere between 20 and 40 years. Horowitz submitted at least 14 trade tickets containing these materially false statements.

48. The same trade tickets also required Horowitz to state the relationship between the owner of the annuity and the annuitant. With respect to each trade ticket that Horowitz submitted for principal review, he falsely stated that there was a "partner" relationship between the owner and the annuitant.

49. In fact, there was no relationship, either familial or business, between the customers purchasing the annuities from Horowitz and the terminally ill hospice patients designated as annuitants. Indeed, the hospice patients had no idea that they had been designated as annuitants or that investors stood to profit from their deaths. Broker-Dealer 1's principals would not have approved Horowitz's annuities sales if they had known that there was no relationship between the annuity purchaser and the annuitant.

50. By providing false information about his customers, Horowitz fraudulently obtained principal approval of his stranger-owned annuities sales, which were then submitted to the variable annuity issuer. As a result of Horowitz's fraudulent acts and practices, the issuer then unwittingly issued stranger-owned variable annuities to Horowitz's customers and paid out substantial upfront sales commissions to Horowitz.

Jane Doe 1: An Illustration of How Horowitz Carried Out the Scheme at Broker-Dealer 1

51. By way of example, Annuitant Finder 1 was approached by John Doe 1, who requested assistance for his wife, Jane Doe 1, who was dying of colon cancer.

52. John and Jane Doe 1 had a young son, and John Doe 1 had a full-time job. Jane Doe 1's condition had reached the point where she required 24-hour nursing, and John Doe 1 was requesting Annuitant Finder 1's help with half of the nursing costs.

53. Annuitant Finder 1 told Horowitz about Jane Doe 1's condition and Horowitz decided to designate Jane Doe 1 as the annuitant in a variable annuity contract that he sold.

54. To that end, in late July 2007, Annuitant Finder 1 and Horowitz met with John and Jane Doe 1 at their home in Los Angeles, under the pretense of providing charitable assistance. Horowitz noted the meeting in his day-timer.

55. During their brief meeting, Annuitant Finder 1 discussed the aid that Jane Doe 1 would need, but neither Annuitant Finder 1 nor Horowitz ever mentioned variable annuities, or proposed designating Jane Doe 1 as an annuitant in variable annuities to be sold to third parties.

56. Shortly after this meeting—and unbeknownst to Jane and John Doe 1—Annuitant Finder 1 emailed Jane Doe 1's name and ID Data (including her social security number and date of birth) to Horowitz's personal email account.

57. On July 31, 2007, Horowitz sold a $1.7 million variable annuity contract to a close family member in which Jane Doe 1 was designated as the annuitant.

58. In order to process this annuity sale, Horowitz completed an electronic trade ticket on which he identified Jane Doe 1 as the investor's "partner." This statement was false because there was no business, familial or other relationship between Jane Doe 1 and the investor.

59. In response to the investment access question on the trade ticket, Horowitz stated that the investor intended to hold the annuity for "25 years." In fact, as Horowitz knew, the investor intended to hold the investment only until Jane Doe 1 died, and Horowitz had selected Jane Doe 1 to be the annuitant because he understood her death to be imminent.

60. Based on these false representations, a Broker-Dealer 1 principal approved the trade ticket and Broker-Dealer 1 electronically submitted the investor's variable annuity

application to the variable annuity issuer, which thereafter unwittingly issued a stranger-owned annuity contract.

61. The variable annuity issuer subsequently paid out a commission to Broker-Dealer 1, with Horowitz netting over $28,500 in commissions on the sale of the annuity.

62. On August 5, 2007, four days after the annuity contract became effective, Jane Doe 1 died. John Doe 1 notified Annuitant Finder 1 of Jane Doe 1's death via email on August 14, 2007. John Doe 1 requested approximately $1,200, representing half the cost of the 24-hour nursing coverage for Jane Doe 1.

63. Annuitant Finder 1 never responded to John Doe 1's August 14 email. Having received no aid or assistance, and no response from Annuitant Finder 1, John Doe 1 wrote to Annuitant Finder 1 again on August 21 and told him to "use the money for someone else that is more in need."

64. Unbeknownst to John Doe 1, Annuitant Finder 1 thereafter obtained a copy of Jane Doe 1's death certificate and provided it to Horowitz. Horowitz used the death certificate to prepare a death benefit claim on the investor's annuity, which was then submitted to the issuer.

65. On October 19, 2007, the investor received a death benefit payout on the "Jane Doe 1" annuity of $2,002,073.85. The investor realized a net profit on his initial $1.7 million investment of $302,073.85—representing a 17.7% rate of return over a period of two and a half months.

Horowitz Falsifies Broker-Dealer 2 Point-of-Sale Forms

66. In mid-November 2007, Horowitz's supervisors at Broker-Dealer 1 discovered that he was selling stranger-owned annuities and instructed him to immediately stop doing so.

67. At the time, Horowitz had over $24 million in variable annuities business pending at Broker-Dealer 1.

68. Unable to sell additional stranger-owned annuities through Broker-Dealer 1, Horowitz sought assistance from a senior associated person of Broker-Dealer 2 ("Senior Rep") in completing the sale of stranger-owned annuities through an affiliate of Broker-Dealer 2.

69. Working with the office staff of the Broker-Dealer 2 affiliate, Respondent Horowitz completed the Broker-Dealer 2 new account forms and deferred variable annuity applications for the deferred variable annuities he had initially intended to sell to his customers through Broker-Dealer 1.

70. In each of those annuities, Horowitz designated a hospice patient as the contract annuitant, utilizing patient ID and Health Data that the Annuitant Finders had obtained and supplied to him. Horowitz did this in an effort to structure the annuities as short-term investment vehicles.

71. As was the case at Broker-Dealer 1, variable annuity sales at Broker-Dealer 2 were subject to principal review and approval to ensure that the proposed sale was suitable and that the investment was being used for its intended purpose. Broker-Dealer 2 representatives were required to complete a new account form that required the representative to state the customer's investment time horizon (*i.e.*, when the customer anticipated accessing their investment) and to disclose certain financial profile information.

72. Broker-Dealer 2 also required its brokers to complete a "Variable Annuity Acknowledgement" form, specifically identifying the surrender charge period associated with the annuity being purchased. As part of the review process, a Broker-Dealer 2 principal closely scrutinized each customer's investment time horizon to ensure that it exceeded the surrender charge period in the deferred variable annuity contract being purchased.

73. Knowing that these stranger-owned annuity sales would be rejected by Broker-Dealer 2's reviewing principals if he provided truthful investment time horizons, Horowitz prepared new account forms falsely stating that the customers intended to hold their annuities from anywhere between 9 to 45 years.

74. The Senior Rep then recruited his subordinate business partner ("Signing Rep") to sign the new account forms and variable annuity applications as the selling registered representative. The Signing Rep agreed to do so in exchange for a percentage of the commissions to be earned on these annuities sales. The Signing Rep did not complete any variable annuity application paperwork or Broker-Dealer 2 new account forms, and he did not consider the purchasers of the annuities to be his customers.

75. By providing false customer information on the Broker-Dealer 2 new account forms, and by using a nominee broker to sign off on the required Broker-Dealer 2 point-of-sale paperwork, Horowitz fraudulently obtained principal approval of stranger-owned annuities sold through Broker-Dealer 2.

76. Working in this manner, between late November 2007 and mid-December 2007, Horowitz was able to effect the sale of at least 12 additional stranger-owned variable annuities – 2 of which were sold to a close Horowitz family member – through Broker-Dealer 2. During the same time period, Horowitz was not an associated person of Broker-Dealer 2, nor was he separately registered with the Commission as a broker or dealer.

Jane Doe 2: An Illustration of how Horowitz Continued the Scheme through Broker-Dealer 2

77. On November 19, 2007—after Horowitz had been instructed by Broker-Dealer 1 to stop selling stranger-owned annuities—Annuitant Finder 1 met with Jane Doe 2, a terminally ill HCP hospice patient, under the pretense of providing charitable assistance through Charity 2. Horowitz travelled with Annuitant Finder 1 to Jane Doe 2's home.

78. Jane Doe 2, dying of stomach cancer, had previously told her HCP social worker about her desire to take her children to Disneyland before she passed away. HCP notified Charity 2 about Jane Doe 2's request for assistance, after first determining that she likely would not live long enough to have her request processed through another well-known charitable foundation.

79. Charity 2 paid $405 towards the cost of the trip to Disneyland, which Jane Doe 2 was able to take with her children. As a condition of the donation, Annuitant Finder 1 required HCP to provide him with Jane Doe 2's ID and Health Data prior to the visit and, thereafter, met with Jane Doe 2 at her home. During the brief meeting, neither Annuitant Finder 1 nor Horowitz mentioned variable annuities or proposed designating Jane Doe 2 as an annuitant in variable annuities to be sold to third parties.

80. On the drive back from Jane Doe 2's home, Horowitz asked Annuitant Finder 1 if he wanted to purchase an annuity on Jane Doe 2's life. Annuitant Finder 1 agreed to do so.

81. On the same day, Horowitz arranged for Annuitant Finder 1 to purchase a deferred variable annuity through Broker-Dealer 2, in which Jane Doe 2 was designated as the contract annuitant. Annuitant Finder 1 provided Horowitz with Jane Doe 2's ID and Health Data (including date of birth, address and social security number) that Horowitz needed in order to designate her as the annuitant in Annuitant Finder 1's annuity. Annuitant Finder 1 invested $1 million in the annuity.

82. To ensure that Annuitant Finder 1's variable annuity application was approved by Broker-Dealer 2, Horowitz made several material false statements on Annuitant Finder 1's Broker-Dealer 2 new account form. First, Horowitz falsely stated that Annuitant Finder 1 had a "27" year investment "time horizon" on his annuity. In fact, Annuitant Finder 1 intended to utilize the annuity as a short-term investment vehicle of no more than several months.

83. Second, Horowitz falsely stated that Annuitant Finder 1's net worth was "$15,000,000" and that Annuitant Finder 1 had liquid assets of "$7,500,000." In fact, Annuitant Finder 1's total net worth was no more than $2 million; he had liquid assets of no more than $750,000 to $1 million; and he had margined his brokerage account to obtain the funds to purchase the annuity.

84. Horowitz falsely inflated Annuitant Finder 1's financials because he knew that Broker-Dealer 2's principals were unlikely to approve a $1 million investment in an illiquid, long-term investment vehicle by a customer with liquid assets equal to or less than that amount.

85. Finally, Horowitz had the Signing Rep sign off as the selling representative on Annuitant Finder 1's new account form and variable annuity application while knowing that Annuitant Finder 1 had never spoken with the Signing Rep concerning the annuity and that the Signing Rep did not consider Annuitant Finder 1 his customer.

86. Based on Horowitz's and the Signing Rep's false representations, a Broker-Dealer 2 principal approved Annuitant Finder 1's variable annuity purchase, and the variable annuity application was submitted to the issuer.

87. On or about November 26, 2007, the issuer unwittingly issued a stranger-owned deferred variable annuity contract to Annuitant Finder 1 in which Jane Doe 2 was the designated annuitant. Because he invested his $1 million in a "bonus" annuity, Annuitant Finder 1's account was credited with $50,000.

88. On December 20, 2007, Jane Doe 2 died. Annuitant Finder 1 obtained a copy of her death certificate and provided it to Horowitz. Horowitz used the death certificate to prepare a death benefit claim on Annuitant Finder 1's "Jane Doe 2" annuity, which was then submitted to the issuer.

89. Annuitant Finder 1 subsequently received death claim payouts from the issuer totaling $1,050,322.60, realizing a net profit of over $50,000 on his initial $1 million investment.

Cohen's Role

90. By early Fall 2007, Horowitz had sold over $20 million of the stranger-owned variable annuities to individual investors but desired to pump greater capital into the scheme. Searching for a large source of financing, Horowitz began pitching his scheme to institutional investors.

91. On or about October 25, 2007, Horowitz met with the principals of two affiliated hedge funds in New York City. As a result of the meeting, the principals decided to establish an affiliated entity, Institutional Investor 1, to facilitate the funds' joint investment in Horowitz's annuity scheme.

92. In December 2007, a certain variable annuity issuer terminated Horowitz's and the Signing Rep's appointments to sell its variable annuity products after determining that Horowitz and the Signing Rep had been selling stranger-owned annuities. Another variable annuity issuer subsequently terminated Horowitz's appointment to sell its annuities as well.

93. Unable to sell annuities through Broker-Dealer 1 or through the Signing Rep, Horowitz sought out a new broker through whom he could perpetuate his scheme.

94. In December 2007, Horowitz met with Cohen in Las Vegas and described his stranger-owned annuities investment strategy to him. At the time, Cohen was a registered representative with Broker-Dealer 3.

95. Horowitz told Cohen that he had a "hedge fund" client, who wanted to invest in stranger-owned variable annuities on a short-term basis. Horowitz told Cohen that Horowitz or his associates would supply Cohen with the customers and the hospice patient annuitants, while Cohen would serve as the registered representative on the additional tranche of stranger-owned variable annuities sales. In exchange, Cohen would pay Horowitz's associates a "consulting fee." Cohen agreed to the arrangement.

96. Between January and February 2008, Cohen, while an associated person of Broker-Dealer 3, sold at least 28 deferred variable annuities contracts to nominees of Institutional Investor 1, utilizing the deferred variable annuity products of at least 7 different insurance companies. Collectively, these nominees purchased approximately $40 million in variable annuities.

97. In each of the annuities he sold, Cohen designated a hospice or nursing home patient as the contract annuitant, utilizing patient ID and Health Data supplied to Cohen by Horowitz's associates (who, in turn, had received the data from Annuitant Finders 2 and 3). Accordingly, Cohen knew that the annuities were being purchased with the intention of using them as vehicles for short-term investment.

98. As was the case at Broker-Dealers 1 and 2, variable annuities sales at Broker-Dealer 3 were subject to principal review to ensure that the proposed sale was suitable and that the investment was being used for its intended purpose. With respect to each annuity contract that he sold, Cohen was required to complete a "variable annuity point of sale" form. Among other information, Cohen was required to state when his customers intended to begin accessing their annuity investment, and whether they intended to do so during the surrender charge period.

99. As part of the principal review, Broker-Dealer 3 principals scrutinized the investment access information that Cohen provided on behalf of his customers to ensure that that each customer would not need access to their investment during the surrender charge period in the annuity being purchased. Each of the variable annuity products that Cohen sold had a surrender charge period of at least 7 years.

100. Knowing that Broker-Dealer 3 would not approve his variable annuity sales if he provided truthful investment access information for his customers, Cohen provided false information regarding how soon the customers intended to access the investment (i.e., not before "11 to 15 years") on each of the 28 Broker-Dealer 3 "Annuity-Point of Sale" forms that he completed.

101. By providing false investment access information for the nominees of Institutional Investor 1, and by failing to disclose that they intended to access their annuities well within the surrender charge period, Cohen was able to fraudulently obtain principal approval of his stranger-owned annuities sales. As a result of Cohen's fraudulent acts and practices, the insurance companies whose variable annuities Cohen sold unwittingly issued stranger-owned variable annuities to Cohen's customers, and paid out substantial upfront sales commissions to Cohen.

Ill-Gotten Gains

102. Horowitz and Cohen earned lucrative upfront commissions on each stranger-owned variable annuity they sold. These commissions were paid by the insurance companies that unwittingly issued the stranger-owned annuities to the representatives' customers. The Signing Rep was also paid commissions on the stranger-owned variable annuities he purported to sell through Broker-Dealer 2. As alleged above, those sales were, in fact, facilitated by Horowitz. The Signing Rep kept only 10% of those commissions and paid the balance over to Broker-Dealer 2's affiliate, which was managed by the Senior Rep, who received more than 20% of the aforementioned commissions.

103. The table below shows the total number of annuities sold by each representative, the total value of the annuities each representative sold, and the total commissions they received on their stranger-owned variable annuity sales.

Registered Representative	Total # of Variable Annuities Sold	Collective Initial Investment Value of Contracts Sold	Total Commissions Realized
Horowitz	14	over $20,000,000	over $300,000
Signing Rep	12	$28,000,000	over $127,000
Cohen	28	over $35,000,000	over $700,000

104. The registered representatives collectively received in excess of $1 million in upfront commissions on more than $80 million in stranger-owned annuity contracts they sold.

105. These commissions were obtained only through the fraudulent and deceptive conduct described herein.

VIOLATIONS

106. As a result of the conduct described above, Horowitz and Cohen each willfully violated Sections 17(a)(1) and 17(a)(2) of the Securities Act, which make it unlawful for any person, in the offer or sale of any securities, directly or indirectly, (1) to

employ devices, schemes or artifices to defraud, or (2) to obtain money or property by means of any materially false statement or materially misleading omission.

107. As a result of the conduct described above, Horowitz and Cohen each willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which make it unlawful for any person, directly or indirectly, in connection with the purchase or sale of a security, to (a) employ devices, schemes, or artifices to defraud, (b) make untrue statements of material fact or omit to state a material fact necessary in order to make statements made, in light of the circumstances under which they were made, not misleading, or (c) engage in acts, practices or courses of business which operate or would operate as a fraud or deceit upon persons.

108. As a result of the conduct described above, Horowitz willfully violated Section 15(a) of the Exchange Act, which makes it unlawful for any person, directly or indirectly, while acting as a broker or dealer, to effect transactions in, or to induce or attempt to induce the purchase or sale of, securities when they are not registered with the Commission as a broker or dealer or associated with any entity registered with the Commission as a broker or dealer.

109. As a result of the conduct described above, Horowitz willfully aided and abetted and caused Broker-Dealer 1's violations of Section 17(a) of the Exchange Act and Rule 17a-3(a)(6) thereunder, and Cohen willfully aided and abetted and caused Broker-Dealer 3's violations of the same provisions. Section 17(a) of the Exchange Act and Rule 17a-3(a)(6) thereunder require that every registered broker or dealer make and keep a memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities. Implicit in these provisions is the requirement that information contained in a required record or report be accurate.

110. As a result of the conduct described above, Horowitz willfully aided and abetted and caused Broker-Dealer 1's and Broker-Dealer 2's violations of Section 17(a) of the Exchange Act and Rule 17a-3(a)(17) thereunder. Section 17(a) of the Exchange Act and Rule 17a-3(a)(17) thereunder require that every registered broker or dealer, and for each account with a natural person as a customer or owner, make and keep an account record, including, among other required information, the account owner's name, tax identification number, address, annual income, net worth, and the account's investment objectives. Implicit in these provisions is the requirement that information contained in a required record or report be accurate.

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 pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents 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 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;

E. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act Respondent Horowitz should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 15(a) and 17(a) of the Exchange Act and Rules 10b-5 and 17a-3 thereunder; whether Horowitz 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 Horowitz should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Section 203 of the Advisers Act, and Section 9 of the Investment Company Act; and

F. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act Respondent Cohen should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act and Sections 10(b) and 17(a) of the Exchange Act and Rules 10b-5 and 17a-3 thereunder; whether Cohen should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, and Section 9(d) of the Investment Company Act; and whether Cohen should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act and Section 9 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 Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against the defaulting 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.

This Order shall be served forthwith upon each 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71714 / March 13, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3793 / March 13, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15789

In the Matter of **MARC STEVEN FIRESTONE** **and** **RICHARD MARK HOROWITZ** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) 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 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), against Marc Steven Firestone ("Firestone") and Richard Mark Horowitz ("Horowitz") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, each Respondent has 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 Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(f) 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' Offers, the Commission finds[1] that:

A. SUMMARY

1. Between mid-November and mid-December 2007, Firestone signed as the registered representative in the sale of twelve deferred variable annuities. Firestone so acted with the knowledge of Horowitz, to whom he reported. With respect to each sale, new account forms of the affiliated broker-dealer, NFP Securities, Inc. ("NFP") included a question regarding the customer's investment "time horizon," which was NFP's term in this context for how soon the customer intended to access the investment. As submitted to NFP, this question was answered on the forms with long-term time periods. Instead, it should have been answered with substantially shorter periods. The incorrect time horizons provided on these forms led to NFP supervisory principals' approval of the sales, which, in turn, allowed the variable annuities to be issued. By negligently allowing new account forms containing the aforementioned incorrect information to be submitted to NFP, Respondents caused NFP to violate Section 17(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 17a-3 thereunder, and each realized commissions deriving therefrom.

B. RESPONDENTS AND ASSOCIATED BROKER-DEALER

2. **Marc Steven Firestone,** age 57, is an insurance agent residing in Los Angeles, California. From January 2004 through May 2008, Firestone was a registered representative with NFP, but has not been associated with a registered entity since then. An employee of Management Brokers, Inc. ("MBI")—a wholly-owned subsidiary and independent affiliate of NFP that sells insurance products—he formerly held Series 6 and 63 securities licenses.

3. **Richard Mark Horowitz,** age 72, is an insurance broker residing in Los Angeles, California and President of MBI where, at all relevant times, Firestone reported to him. He was a registered representative with NFP between January 2004 and May 2008, but has not been associated with a registered entity since then. He formerly held Series 6 and 63 securities licenses.

4. **NFP Securities, Inc. ("NFP")** is a broker-dealer and an investment adviser, registered as both with the Commission, and headquartered in New York, New York.

[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.

C. FACTS

5. Between mid-November and mid-December 2007, Respondent Firestone signed as the registered representative on the sale of twelve deferred variable annuities, each of which was sold through NFP. The customers purchasing these twelve variable annuities included natural persons.

6. In so signing, Respondent Firestone acted with the knowledge of Respondent Horowitz, the President of MBI, to whom Firestone reported, and who shared in commissions generated by Firestone. As Respondents knew contemporaneously, in all twelve of these sales, customers intended for their variable annuity purchases to be short-term investments.

7. Each of the aforementioned variable annuity sales was subject to supervisory principal review by NFP, and could be submitted to the issuer for consummation only after NFP principal approval of each proposed sale. That review, in turn, required Respondents to furnish a completed new account form, for each annuity sale, containing information that included the customer's investment "time horizon," which was NFP's term in this context for how soon the customer intended to access his or her investment. As Respondents should have known, NFP's reviewing principals scrutinized each customer's investment "time horizon" to ensure that it exceeded the multi-year "surrender charge" period for the deferred variable annuity being purchased.[2]

8. Without reviewing the new account forms (which neither Respondent had prepared), Firestone signed and submitted them to NFP. As submitted, all twelve answered the time horizon question with long-term periods, each exceeding the relevant surrender-charge period. These answers were incorrect because the customers purchasing the annuities intended to hold their investments for much shorter periods.

9. All twelve annuities sales subsequently withstood NFP's principal review. This, in turn, led to issuance of the annuities. Had accurate time horizons been provided on the new account forms, however, none of these annuities would have withstood NFP's principal review.

10. Of the total commissions paid by the annuity issuers on the twelve annuities referenced above, Respondent Horowitz received $292,767.89, and Respondent Firestone received $127,853.20.

D. VIOLATIONS

11. Section 17(a) of the Exchange Act [15 U.S.C. § 78q(a)] and the rules thereunder require a registered broker or dealer to make and keep current specific books and records relating to its business. Exchange Act Rule 17a-3(a)(17) [17 C.F.R. §§ 240.17a-3(a)(17)] requires, in pertinent part, that every registered broker or dealer make and keep an account record for each

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[2] The "surrender charge" period embraces the years following purchase during which charges as high as 7 to 10% of any amounts withdrawn are generally assessed.

account with a natural person as a customer or owner, that includes, among other things, the account's investment objectives. Implicit in these provisions is the requirement that information contained in a required record or report be accurate, *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Exchange Act Rel. No. 33367, 55 SEC Docket 1970 (Jan. 11, 1994), regardless of whether the information entered itself is mandated. *See Sinclair v. SEC*, 444 F.2d 399, 401 (2nd Cir. 1971); *In re James F. Novak,* Exchange Act Release No. 19660 (Apr. 8, 1983).

12. Firestone and Horowitz should have known that the time horizon entries in the new account forms submitted to NFP for the twelve sales described above were incorrect. The NFP new account forms that Firestone signed, and which were submitted to NFP, constituted required books and records under Exchange Act Rule 17a-3(a)(17), and were relied on by NFP's supervisory principals in approving these annuity sales.

E. FINDINGS

13. As a result of the conduct describe above, the Commission finds that Respondents caused NFP to violate Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondents Firestone and Horowitz, and each of them, cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

B. Respondent Firestone shall, within ten (10) days of the entry of this Order, pay (i) disgorgement of $127,853.20 plus prejudgment interest of $17,140.89; and (ii) a civil money penalty in the amount of $40,800, to the United States Treasury. If timely payment of disgorgement 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 shall be made in conformity with the payment procedures detailed in paragraph V.D. below.

C. Respondent Horowitz shall, within ten (10) days of the entry of this Order, pay: (i) disgorgement of $292,767.89 plus prejudgment interest of $36,512.20; and (ii) a civil money penalty in the amount of $40,800, to the United States Treasury. If timely payment of disgorgement 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 shall be made in conformity with the payment procedures detailed in paragraph V.D. below.

D. All payments required by this Order must be made in one of the following ways:

(1) 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
(2) 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 the paying Respondent both by name and as a Respondent in these proceedings, and the file number of these proceedings; regardless of the form of payment, a copy of the cover letter and form of payment must be sent to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71713 / March 13, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3792 / March 13, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 30980 / March 13, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15788

In the Matter of

HOWARD FEDER
and BDL MANAGER LLC,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Howard Feder ("Feder") and BDL Manager LLC ("BDL Manager") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Section 203(f) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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

SUMMARY

1. These proceedings arise from a fraudulent scheme to profit from the imminent deaths of terminally ill hospice and nursing home patients through the purchase and sale of deferred variable annuities ("variable annuities"). Between November 2007 and February 2008, BDL Group, a pooled investment vehicle, purchased more than $56 million of the variable annuities through nominees. Respondents Feder and BDL Manager, the investment adviser to BDL Group, provided material false information to the registered representatives who sold the annuities, and participated in a fraudulent scheme to secure broker-dealer approvals of the annuities sales.

RESPONDENTS

2. **Howard A. Feder,** age 43, resides in Woodmere, New York. Since November 2007, Feder has been the sole Member of BDL Manager LLC and the sole principal and employee of BDL Group. Feder has no ownership interest in BDL Group. From 2002 through at least May 2011, Feder periodically worked as a commodities trader.

3. **BDL Manager LLC** is a Delaware limited liability company with its principal place of business in Woodmere, New York. BDL Manager is the investment adviser to BDL Group. BDL Manager has never been registered with the Commission.

OTHER RELEVANT INDIVIDUALS AND ENTITIES

4. **BDL Group LLC** is a Delaware limited liability company with its principal place of business in Woodmere, New York. BDL Group was created on or about November 7, 2007 to facilitate institutional investment in variable annuities through the use of nominees.

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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.

5. **Michael Horowitz**, the scheme architect, was employed as a registered representative of a large, wire-house broker-dealer firm ("Broker-Dealer 1") during part of the relevant time period.

6. **Broker-Dealer 1** is a broker-dealer and investment adviser registered with the Commission and headquartered in New York, New York.

7. **Broker-Dealer 2** is a broker-dealer and investment adviser registered with the Commission and headquartered in New York, New York.

8. **Broker-Dealer 3** is a broker-dealer and investment adviser registered with the Commission and headquartered in Oakdale, Minnesota.

THE SCHEME

9. In or about May 2007, Michael Horowitz ("Horowitz") devised a scheme to exploit the death benefit and "bonus credit" components of the variable annuity contracts he subsequently sold by designating terminally ill hospice and nursing home patients as the contract annuitants.

10. Variable annuities are designed to serve as long term investment vehicles, typically to provide income at retirement. Although variable annuities offer investment features similar in many respects to mutual funds, a typical variable annuity offers certain features not commonly found in mutual funds, including death benefits[2] and/or bonus credits.[3] Horowitz solicited wealthy individual and institutional investors to make large investments in variable annuities that offered these benefits.

11. In each of these contracts, a terminally ill hospice or nursing home patient was designated as the contract annuitant. At least 16 terminally ill hospice patients were designated as annuitants in more than 50 variable annuities sold by Horowitz and the other registered representatives that he recruited to the scheme (collectively, the "Registered Representatives"). All of the hospice patients were residents of southern California or Chicago, Illinois.

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[2] The typical variable annuity death benefit provides for a payment to the beneficiary at the contract annuitant's death equal to either the value of the underlying investment portfolio or the purchase price of the annuity less any withdrawals, whichever is greater. This death benefit option allows an investor to profit from positive investment performance as part of the death benefit while providing a hedge against losses in the portfolio's value by providing for a payout equal to at least the amount invested in the annuity less any withdrawals. In the typical variable annuity, the contract owner is also the contract "annuitant." However, in the scheme described herein, hospice and nursing home patients unrelated to the contract owners were designated as the annuitants.

[3] A bonus credit is a sum of money immediately credited to the contract owner's investment account by the annuity issuer (typically a percentage of the premiums being invested in the annuity contract). For example, certain investors that purchased variable annuities through Horowitz made an initial investment of $1 million and received "bonus credits" that increased the value of their annuity by 5% ($50,000) to $1,050,000.

12. The hospice patients designated as annuitants had no familial or business relationship with the investors who purchased the annuities. Instead, they were selected based on their terminal illnesses and the likelihood that they would die soon, and thereby trigger death benefit payouts in variable annuity contracts in the very near term. As part of his pitch to investors, Horowitz told them that he would supply the annuitants, with investors needing to furnish only their funds.

13. These "stranger annuitants" likewise had no contractual right to any portion of the death benefits paid out under the terms of the variable annuities sold during the scheme. Instead, each of the contracts directed these benefits be paid to one of the investor's family members or relatives, or to a family trust created by the investor.

14. Anticipating that the annuitants would soon die, triggering death benefit payout elections in the annuity contracts, Horowitz advised his customers to invest their premiums aggressively because if the value of their portfolio increased, they would receive the portfolio value as the death-benefit payout. If the value of their portfolio decreased, the death benefit nonetheless guaranteed them a payout equal to the value of their premiums paid minus any withdrawals. Horowitz also advised his customers to invest large sums of money in each annuity they purchased to maximize their "bonus credit."

15. The Registered Representatives obtained their firms' approval of the variable annuity sales by making material misrepresentations and omissions on new account and point-of-sale forms, which the broker-dealer principals used to conduct investment suitability reviews.

BDL Group Invests in Stranger-Owned Annuities through Nominees

16. By early Fall 2007, Horowitz had sold more than $27 million of the stranger-owned variable annuities to individual investors but desired to generate greater capital into the scheme. Searching for a large source of financing, Horowitz began pitching his scheme to institutional investors.

17. On or about October 25, 2007, Horowitz met with the principals of two affiliated hedge funds in New York City. As a result of the meeting, the principals decided to establish an affiliated entity, named BDL Group LLC, advised by BDL Manager LLC, to facilitate the funds' joint investment in Horowitz's annuity scheme.

18. In late October 2007, the hedge fund principals retained Feder, a commodities trader, to operate BDL Manager and BDL Group as each entity's sole principal and employee. From the outset, Feder understood the key components of the investment strategy, including that it entailed: (i) exploiting the bonus credit and enhanced death benefit provisions of the annuities contracts for "guaranteed" short-term gains; (ii) designating terminally ill hospice and nursing home patients as the annuitants in the expectation that BDL Group would receive death benefit payouts within a few months; (iii) allocating the annuity premiums to aggressive equity sub-

accounts with the assurance that, because of the death benefit provisions, BDL Group could gain on market upside, but not lose on market downside; and (iv) rolling the death benefit proceeds, as the annuitants died, into new stranger-owned annuity transactions to generate additional profits for BDL Group and commissions for the brokers.

19. BDL Manager, BDL Group, the fund principals, and Horowitz agreed that: (i) Horowitz and his associates would bear sole responsibility for identifying and communicating with the terminally ill annuitants; and (ii) BDL Group would invest in the annuities through nominees enlisted by the hedge funds.

20. BDL Group's Certificate of Formation, issued by the State of Delaware on November 7, 2007, stated that the company's business consisted solely of investing and reinvesting in variable annuities through nominees.

21. By November 14, 2007, several of the nominees had signed "Nominee Agreements" with BDL Group providing that: (i) BDL Group would deposit funds to purchase the annuities in a brokerage account to be opened by the nominee; (ii) BDL Group would have complete discretion with respect to investing the funds and would be "entitled to all earnings, proceeds, or other profits earned" from the annuities; and (iii) BDL Group would compensate the nominee in an amount equal to $20,000 on an annualized basis. Feder executed the "Nominee Agreements" as the principal of BDL Manager, on behalf of BDL Group.

22. Between November 2007 and February 2008, BDL Group invested more than $56 million in 36 variable annuity contracts issued by 8 insurance companies. The annuities were sold either through Broker-Dealer 2 or Broker-Dealer 3. BDL Group purchased 8 of the contracts through individual nominees, and the remaining contracts were purchased through family trusts that Feder arranged to have established for several of the nominees. The family trusts functioned in the same manner as the individual nominees – that is, as mere conduits for BDL Group's funding of, and receipt of proceeds from, the variable annuities. None of the trusts had an independent trust *res*, or any assets not belonging to BDL Group.

23. Each of the BDL Group-funded contracts purchased through a nominee designated a terminally ill hospice or nursing home patient as the annuitant.

False Financial Profile Information is Provided for BDL Group's Nominees

24. Feder was aware that the broker-dealers that sold annuities to BDL Group's nominees reviewed each proposed sale to ensure that it was suitable. Broker-Dealer 2 and Broker-Dealer 3 required their registered representatives to complete new account or point-of-sale forms for each proposed annuity sale that disclosed certain financial profile information and stated when the customer anticipated accessing its investment. The representatives submitted the forms to principals at their firms who were responsible for conducting the suitability reviews.

25. Feder knew, or was reckless in not knowing, that the financial profile information requested on the new account and point-of-sale forms was used for suitability purposes, and that high net-worth individuals would more readily secure approvals.

26. In December 2007, Feder knowingly or recklessly handwrote false financial information on a nominee's new account form for Broker-Dealer 2, after first instructing the nominee to sign the form in blank. Feder then provided the form for submission through Broker-Dealer 2, without ever furnishing the completed form to the nominee for review. Feder stated that the nominee had (i) an estimated net worth in excess of $10 million, excluding the nominee's home, (ii) liquid assets consisting of cash or cash equivalents in excess of $3 million, and (iii) an estimated annual income in excess of $1 million.

27. In fact, at the time the nominee signed the new account form for Broker-Dealer 2, the nominee did not have a net worth, liquid assets, or an annual income even approaching the figures written by Feder on the form.

28. On January 16, 2008, Feder sent emails to Horowitz, and one of Horowitz's associates, in which he knowingly or recklessly repeated the same false financial information that he had handwritten on the nominee's Broker-Dealer 2 form.

29. In his January 16, 2008 emails, Feder described a second nominee as also having an estimated net worth in excess of $10 million and an estimated annual income in excess of $1 million. At Feder's behest, in November 2007, this nominee had signed in blank a Broker-Dealer 2 new account form that one of the registered representatives subsequently filled in with information indicating that the nominee had an estimated net worth of only $5 million and estimated annual income of only $600,000.

30. Several of the Broker-Dealer 3 point-of-sale forms that Feder directed the family trust nominees to sign in blank were subsequently filled out by the Registered Representatives with false financial profile information. Each of the point-of-sale forms signed by the family trust nominees stated that the trust had cash and an estimated net worth in excess of $18 to $20 million, as well as an approximate annual income in excess of $1 to $1.2 million.

31. In reality, as Feder knew, or was reckless in not knowing, none of the trusts had any independent trust *res*, net worth, or annual income. Instead, each trust functioned as a kind of pass-through entity for BDL Group. As soon as Feder wired funds from BDL Group into a trust bank account, the trustee wired out the funds again to purchase the annuities. On receipt of death benefit proceeds from the annuity issuers, the trustee wired the proceeds back to BDL Group. Rather than noting the trusts' lack of independent funds, Feder and the nominees left the forms blank to be completed by the Registered Representatives.

32. To secure approvals for variable annuity sales from the broker-dealers, Feder instructed the nominees to sign only blank copies of the new account and point-of-sale forms, and he never provided the nominees with the completed forms. In addition to the false information that

Feder directly supplied, he also permitted the Registered Representatives to complete the blank, signed new account and point-of-sale forms and submit them to the broker-dealers. In doing so, Feder knew, or was reckless in not knowing, that the representatives would make false statements on the forms, and that the broker-dealers would rely on them.

33. The false financial profile information was material because it was relevant to the broker-dealers' suitability determinations and approval of the annuities sales.

False Investment Access Information Is Provided for BDL Group's Nominees

34. Feder understood the meaning of the term "time horizon" in connection with the annuities investments, and that information concerning when the customer anticipated accessing the investment was requested for suitability and approval purposes.

35. Feder was well aware that the purpose of Horowitz's scheme was to designate terminally ill patients as annuitants in the expectation that their deaths would result in lucrative payouts for BDL Group within a few months and certainly less than a year.

36. Feder instructed the nominees to sign in blank each of the new account and point-of-sale forms, and the Registered Representatives filled them in with false "time horizons" and investment access information before submitting the forms to the broker-dealers for principal review. The forms for Broker-Dealer 2 falsely stated that the nominees' "time horizons" were anywhere between "9" and "45" years, and for Broker-Dealer 3, that they intended to access their investments in "eleven to fifteen years."

37. Feder knew, or was reckless in not knowing, that the Registered Representatives would provide false "time horizons" on the Broker-Dealer 2 new account forms and false investment access information on the Broker-Dealer 3 point-of-sale forms.

38. The false "time horizons" and investment access periods were material because, had accurate information been provided, the broker-dealers would have rejected the annuity sales or, at the very least, subjected them to heightened scrutiny.

Ill-gotten Gains

39. BDL Group received at least $1,550,565.55 in proceeds from its investment in the annuities.

VIOLATIONS

40. As a result of the conduct described above, Respondents Feder and BDL Manager willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

III.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 21C of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

Respondent Feder

A. Respondent Feder cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Feder 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.

C. Any reapplication for association by Respondent Feder 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 Respondent Feder, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

Respondent Feder shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $130,000 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 make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(2) 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 Howard Feder 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 Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

Respondent BDL Manager

A. Respondent BDL Manager cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent BDL Manager shall, within ten (10) days of the entry of this Order, pay disgorgement of $1,550,565.55 and prejudgment interest of $196,608.97, and a civil penalty of $1,550,565.55, for a total payment of $3,297,740.07, to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or 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 BDL Manager LLC 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 Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549 .

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71712 / March 13, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 30979 / March 13, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15787

In the Matter of **HAROLD TEN,** **MENACHEM "MARK" BERGER, and** **DEBRA FLOWERS,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO 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 Sections 15(b) 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 Harold Ten ("Ten"), Menachem "Mark" Berger ("Berger"), and Debra Flowers ("Flowers") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to 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 Respondents' Offers, the Commission finds[1] that:

SUMMARY

1. These proceedings arise from a fraudulent scheme to profit from the imminent deaths of terminally ill hospice and nursing home patients through the purchase and sale of more than $80 million in deferred variable annuities ("variable annuities") between July 2007 and at least February 2008.

2. The scheme was orchestrated by Michael A. Horowitz ("Horowitz"), then a registered representative of a large broker-dealer firm ("Broker-Dealer 1"). Horowitz, together with Ten, and Berger and Flowers (employees of Chicago area nursing homes), made material misrepresentations and used deceptive devices to obtain the personal health and identifying information ("ID and Health Data") of terminally ill hospice and nursing home patients in order to designate them as annuitants on variable annuity contracts that Horowitz marketed to wealthy investors. Horowitz marketed these variable annuities – which are designed by their issuers to be long term investment vehicles – as opportunities for short-term gains. Horowitz and the other registered representatives he recruited to the scheme (collectively, the "Registered Representatives") obtained their firms' approval of the variable annuity sales by making material misrepresentations and omissions on trade tickets, customer account forms and/or point-of-sale forms, which the broker-dealer principals used to conduct investment suitability reviews.

RESPONDENTS

3. **Harold Ten**, age 50, is a resident of Los Angeles, California. Ten was recruited to the scheme by Horowitz to identify terminally ill persons and obtain their ID and Health Data, and supply it to Horowitz for use in variable annuities transactions (a role hereinafter referred to as "annuitant finder"). In or about June 2007, Ten began to conduct business as "Raphael Health," an entity that purported to provide charitable assistance to patients in hospice care.

4. **Menachem "Mark" Berger**, age 40, is a resident of Chicago, Illinois. Also recruited by Horowitz as an "annuitant finder" for the scheme, Berger is the executive director of an entity which owns and operates nursing home facilities in Chicago, Illinois. Berger is also the owner of Patient Financial Services, Inc., an entity that purported to be in the business of providing financial support to individuals with terminal medical diagnoses.

5. **Debra Flowers**, age 37, is a resident of Chicago, Illinois. Flowers served as an "annuitant finder" for the scheme after being recruited by Berger. At various times, Flowers has been employed by Berger as an admissions and marketing director for nursing homes managed by Berger.

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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 INDIVIDUALS AND ENTITIES

6. **Horowitz**, the scheme architect, was employed as a registered representative of a large, wire-house broker-dealer firm during part of the relevant time period ("Broker-Dealer 1").

7. **Broker-Dealer 1** is a broker-dealer and investment adviser registered with the Commission and headquartered in New York, New York.

8. **Broker-Dealer 2** is a broker-dealer and investment adviser registered with the Commission and headquartered in New York, New York.

9. **Broker-Dealer 3** is a broker-dealer and investment adviser registered with the Commission and headquartered in Oakdale, Minnesota.

10. **Raphael Health** was established by Ten in or about June 2007, as a registered d/b/a of an existing non-profit 501(c)(3) organization ("Charity"). Also in or about June 2007, Ten set up a web page for Raphael Health, which described Raphael Health as an organization "dedicated to helping patients with a life limiting illness to live their remainder days in comfort and dignity." At all relevant times, Raphael Health's activities were overseen by Ten.

11. **Patient Financial Services LLC** is an Illinois limited liability company with its principal place of business in Lincolnwood, Illinois. Patient Financial Services was incorporated in Illinois and, during the relevant time period, purported to be in the business of providing financial support to patients with terminal medical diagnoses.

THE RESPONDENTS' SCHEME

12. In or about May 2007, Horowitz devised a scheme to exploit the death benefit and "bonus credit" components of the variable annuity contracts he subsequently sold by designating terminally ill hospice and nursing home patients as the contract annuitants.

13. Variable annuities are designed to serve as long-term investment vehicles, typically to provide income at retirement. Although variable annuities offer investment features similar in many respects to mutual funds, a typical variable annuity offers certain features not commonly found in mutual funds, including death benefits[2] and/or bonus credits.[3] Horowitz solicited wealthy individual and institutional investors to make large investments in variable annuities that offered these benefits.

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[2] The typical variable annuity death benefit provides for a payment to the beneficiary at the contract annuitant's death equal to either the value of the underlying investment portfolio or the purchase price of the annuity less any withdrawals, whichever is greater. This death benefit option allows an investor to profit from positive investment performance as part of the death benefit while providing a hedge against losses in the portfolio's value by providing for a payout equal to at least the amount invested in the annuity less any withdrawals. In the typical variable annuity, the contract owner is also the contract "annuitant." However, in the scheme described herein, hospice and nursing home patients unrelated to the contract owners were designated as the annuitants.

[3] A bonus credit is a sum of money immediately credited to the contract owner's investment account by the annuity issuer (typically a percentage of the premiums being invested in the annuity contract). For example, certain investors that purchased variable annuities through Horowitz made an initial investment of $1 million and received "bonus credits" that increased the value of their annuity by 5% ($50,000) to $1,050,000.

14. In each of these contracts, a terminally ill hospice or nursing home patient was designated as the contract annuitant. At least 16 terminally ill hospice patients were designated as annuitants in more than 50 variable annuities sold by the Registered Representatives. All of the hospice patients were residents of southern California or Chicago, Illinois.

15. The hospice patients designated as annuitants had no familial or business relationship with the investors who purchased the annuities. Instead, they were selected based on their terminal illnesses and the likelihood that they would die soon, and thereby trigger death benefit payouts in variable annuity contracts in the very near term. As part of his pitch to investors, Horowitz told them that he would supply the annuitants, with investors needing to furnish only their funds.

16. These "stranger annuitants" likewise had no contractual right to any portion of the death benefits paid out under the terms of the variable annuities sold during the scheme. Instead, each of the contracts directed that these benefits be paid to one of the investor's family members or relatives, or to a family trust created by the investor.

17. Anticipating that the annuitants would soon die, triggering death benefit payout elections in the annuity contracts, Horowitz advised his customers to invest their premiums aggressively because if the value of their portfolio increased, they would receive the portfolio value as the death benefit payout. If the value of their portfolio decreased, the death benefit nonetheless guaranteed them a payout equal to the value of their premiums paid minus any withdrawals. Horowitz also advised his customers to invest large sums of money in each annuity they purchased to maximize their "bonus credit."

18. Horowitz employed at least two varieties of fraud in carrying out his sale of "stranger-owned" annuities. First, Horowitz (as well as Respondents Ten, Berger and Flowers) fraudulently obtained and used the ID and Health Data of certain unwitting terminally ill hospice and nursing home patients who were designated as annuitants. Second, the Registered Representatives falsified broker-dealer trade tickets, customer account forms and/or point-of-sale forms (including suitability questionnaires) to obtain supervisory approval of the annuities that were sold pursuant to the scheme.

Respondents Ten, Berger and Flowers Obtain Confidential ID and Health Data through Deceptive Practices

19. To implement his plan, Horowitz needed a ready supply of terminally ill persons, unrelated to the investors, to use as annuitants in variable annuity sales. Horowitz recruited Ten and Berger to identify the terminally ill persons to be used as annuitants. Berger then recruited Flowers. Working with Horowitz, these "annuitant finders" engaged in a scheme to obtain the patients' confidential ID and Health Data, which they then fraudulently misused. Horowitz needed patients' Health Data to confirm that the individuals he designated as annuitants had a terminal medical diagnosis. He needed their ID data (including social security number and date of birth) to designate them as annuitants and to submit death benefit claims to the issuers whose annuities he sold.

Ten, Raphael Health and the California Annuitants

20. Horowitz approached Ten in May 2007 and described his stranger-owned annuities scheme to Ten.

21. After a series of closed-door meetings between Horowitz and Ten at Charity's offices in May 2007, Ten told his assistant that he was going to start a charity called "Raphael Health." Raphael Health was purportedly going to focus on providing charitable assistance exclusively to hospice care patients.

22. Raphael Health was used in the scheme to obtain patient ID and Health Data. On June 1, 2007, Ten filed a fictitious name certificate with the State of California, allowing one of his existing charities to do business under the name "Raphael Health."

23. Ten created a website for Raphael Health and set up Raphael Health email accounts. The Raphael Health webpage stated that Raphael Health was

> an organization dedicated to helping patients with a life limiting illness to live their remainder days in comfort and dignity.... Through the generosity of private and corporate philanthropists Raphael Health helps patients who[] have chosen hospice care and are at home or in a facility....

24. In reality, Raphael Health had no private or corporate donors, and its true purpose was to obtain hospice patient ID and Health Data for Horowitz's use in selling stranger-owned annuities on those patients' lives. Raphael Health's website failed to disclose these facts.

25. In July 2007, Ten opened a bank account in the name of Raphael Health, and funded it with several thousand dollars from his personal bank account. These funds were to be used for the charitable donations Ten planned to offer hospice patients as part of the plan to obtain their ID and Health Data.

26. Beginning in June 2007, Ten held Raphael Health out as a charity devoted to providing assistance to hospice patients. Ten solicited hospice care providers in Los Angeles, San Francisco and New Orleans by touting Raphael Health's purported charitable services. In contemporaneous emails to those hospice care providers, Ten and his assistant described Raphael Health as a "non-profit 501(c)(3) organization."

27. In June 2007, Ten met with the Director of Development of a southern California hospice care provider ("HCP") During the June 2007 meeting, Ten told HCP's Director of Development that Raphael Health

> was an organization of some large, very high profile donors, the type of donors whose names are often on the sides of buildings at Universities, that sort of donor, Universities, hospitals. And that in this instance, they wanted to give and remain anonymous in that gift so that they had established Raphael Health....[Harold Ten] indicated that they would like to see the patient, they would like to meet the patient. He, specifically. And the purpose for that was that they could tell – he could tell their

donors or his donors who those individuals were that they were actually meeting – so he would be able to tell a story to help receive other donations to continue those donations to come into the individual patient requests that they were filling.

28. Ten's statements to HCP's Director of Development were false because, among other reasons, Raphael Health had no donors other than Ten himself.

29. Ten implied that there were conditions on the purported aid to be offered. First, only HCP hospice patients (*i.e.*, those who had been diagnosed with terminal illnesses and were receiving only palliative care in their home), as opposed to other HCP patients receiving in-home curative care or treatment, were eligible for Raphael Health's donations. Second, Ten usually capped the amount to be donated per patient at between \$250-\$500. Third, Raphael Health required that HCP provide it with the following information concerning any candidate for a donation: (i) the patient's name and address; (ii) the patient's date of birth; (iii) the patient's social security number; (iv) the patient's medical diagnosis; and (v) confirmation that the patient was receiving hospice care. This was the information that Horowitz needed to designate the hospice patients as annuitants. Finally, Ten conditioned the donations on his right to visit HCP patient in question. Ten told HCP that he wanted to be able to tell his donors each patient's "story" to help raise additional donations for other patients. After visiting Raphael Health's website to confirm the legitimacy of the charity, HCP administrator—grateful for what he understood to be Raphael Health's purely charitable donations to HCP's hospice patients—agreed to Ten's conditions.

30. Ten never told HCP that he planned to forward patient personal identifying information to Horowitz, or that Horowitz wanted to sell annuity contracts to third parties who would profit when HCP patients died.

31. Between late July 2007 and at least December 2007, Ten met with multiple HCP hospice patients and with certain patients receiving care from other hospice providers. These meetings took place at the patients' homes. Horowitz attended many of these meetings.

32. Social workers from HCP also attended the meetings with HCP hospice patients. Ten told the HCP social workers that he wanted to meet with the patients who were receiving charitable assistance from Raphael Health so he could tell their story to Raphael Health's "donors." According to one HCP social worker

> When – at the meeting when we met with the patient in their home, before we met, they, he and [Horowitz], met me and stated that the patients – the donors for this money did not want to give to hospitals. They didn't want to give to big organizations, that they would just receive a nameplate.
>
> They wanted to see where their money was being spent; so therefore, Harold and [Horowitz] showed up. They had a box of candy for the patient.

33. The patients, their families and their HCP health care providers all believed that the purpose of the visits was charitable. However, Horowitz's true purpose in visiting patients

was to confirm that they were in fact dying, and, therefore, that they were suitable annuitants. Horowitz actively concealed his true purpose for attending from HCP and the hospice patients that he visited.

34. Unbeknownst to the HCP and its patients, after each patient meeting, Ten provided Horowitz with the ID and Health Data that he obtained from the HCP under false pretenses. Horowitz, in turn, used patient ID and Health Data to sell variable annuities in which the hospice patients were designated as the contract annuitants.

35. Between July 2007 and at least December 2007, Ten provided Horowitz with the names and ID data of hospice patients in southern California. At least six of these patients were designated as annuitants in at least 18 variable annuities sold by Horowitz and a second representative that Horowitz recruited to the scheme, with some of the patients designated as annuitants in multiple policies.

36. As part of the ruse, Ten asked HCP to keep him informed of the health status of each patient whom he had visited, falsely telling HCP that Raphael Health's "donors" wanted to remain apprised of each patient's story. In reality, Horowitz and Ten wanted this information so they would know when each patient died and Horowitz could file annuity death benefit claims for his customers, who then stood to receive payouts on their variable annuity investments. As part of the scheme, Ten obtained death certificates for each of the patients who had been designated as an annuitant and provided the death certificates to Horowitz for his use in filing death benefit claims.

37. HCP, its hospice patients, and their families were completely unaware that Horowitz had sold variable annuities on the lives of HCP hospice patients and that third parties stood to profit from their deaths.

38. Ten has never been registered with the Commission as a broker or dealer, or been an associated person of a registered broker or dealer. However, during the relevant period and based on the foregoing, Ten was an associated person of Horowitz, who was acting as a broker, but who was not separately registered as a broker or dealer.

Ten Purchases an Annuity on the Life of an HCP Hospice Patient

39. Ten also purchased an annuity on the life of one of the HCP hospice patients he visited. On November 19, 2007, Ten met with "Jane Doe," a terminally ill HCP hospice patient, under the pretense of providing charitable assistance through Raphael Health. Horowitz traveled with Ten to Jane Doe's home.

40. Jane Doe, dying of stomach cancer, had previously told her HCP social worker about her desire to take her children to Disneyland before she passed away. HCP notified Raphael Health about Jane Doe's request for assistance, after first determining that she would likely not live long enough to have her request processed through another well-known charitable foundation.

41. Raphael Health reimbursed HCP for the cost of the trip to Disneyland, which Jane Doe was able to take with her children. As a condition of the donation, Ten required HCP to

provide him with Jane Doe's ID and Health Data prior to the visit and thereafter met with Jane Doe at her home. During the brief meeting, neither Ten nor Horowitz mentioned variable annuities or proposed designating Jane Doe as an annuitant in variable annuities to be sold to third parties.

42. On the drive back from Jane Doe's home, Horowitz asked Ten if he wanted to purchase an annuity on Jane Doe's life. Ten agreed to do so. On the same day, Horowitz arranged for Ten to purchase a deferred variable annuity through Broker-Dealer 2, in which Jane Doe was designated as the contract annuitant. Ten provided Horowitz with Jane Doe's ID and Health Data (including date of birth, address and social security number) that Horowitz needed in order to designate her as the annuitant in Ten's annuity. Ten invested $1 million in the annuity.

43. On or about November 26, 2007, a deferred variable annuity was issued to Ten in which Jane Doe was the designated annuitant. Because he invested his $1 million in a "bonus" annuity, Ten's account was credited with $50,000.

44. On December 20, 2007, Jane Doe died. Ten obtained a copy of her death certificate and provided it to Horowitz. Horowitz used the death certificate to prepare a death benefit claim on Ten's "Jane Doe" annuity, which was then submitted to the issuer.

45. Ten subsequently received death claim payouts from the issuer totaling $1,050,347.64, realizing a net profit of $50,347.64 on his initial $1 million investment.

Berger, Flowers and the Chicago Annuitants

46. In Fall 2007, Horowitz decided to grow his variable annuity business by expanding the pool of terminally ill individuals available to be designated as annuitants. He travelled to Chicago, Illinois in October 2007, and met with Respondent Berger. Berger was an executive officer of a privately held company that owned and operated nursing homes in the Chicago area.

47. Horowitz told Berger that he was selling variable annuities on the lives of terminally ill hospice patients to wealthy investors and, through his conversations with Horowitz, Berger understood that the annuitants' deaths were critical to Horowitz's investment strategy.

48. Horowitz told Berger that he needed the ID and Health Data of patients with a life expectancy of three to six months. As a nursing home executive, Berger had access to patient medical files containing patient ID and Health Data.

49. Horowitz agreed to pay Berger $25,000 for each patient that Berger identified. Half of that amount was to be paid up front, with the remaining $12,500 to be paid when the patient-annuitant died. As part of their arrangement, Berger also agreed to keep Horowitz apprised of the health status of the patient-annuitants, and to provide Horowitz with death certificates when the patients died.

50. Berger, in turn, recruited Respondent Flowers to approach terminally ill nursing home patients and their families. Flowers was, at various times, a nursing home admissions director and a marketing consultant.

51. Flowers recruited a third health care provider, "Health Care Provider 1," to the scheme. Like Berger and Flowers, Health Care Provider 1 had access to patient medical records and the ability to identify patients admitted to hospice care. Flowers agreed to compensate Health Care Provider 1 in exchange for his identifying patients admitted to hospice care.

52. By virtue of their access to confidential patient medical files, Berger, Flowers and/or Health Care Provider 1 identified terminally ill hospice patients at nursing homes and elsewhere in the Chicago area and, in some instances, were able to obtain the patients' confidential ID and Health Data. They focused their efforts on indigent patients.

53. Flowers then approached certain of these terminally ill patients (or caregiving family members of the patients) under the guise of providing charitable financial assistance or under other false pretenses. For instance, Flowers told the caregivers of several hospice patients that she represented "companies looking to take tax write-offs," and that the companies were offering "no obligation funeral insurance." Flowers told another caregiver that she represented a "group of rich investors who invested in charities that helped patients who were in poor health and had financial problems."

54. Flowers' true purpose in meeting with the terminally ill patients and/or their caregivers was to obtain their signature on a document that Horowitz (or others working with him) had provided to her for use with the patients. This document was misleadingly titled "Standard Authorization, Release and Indemnity for Release of Medical and Personal Information (HIPAA Compliant)." However, the document was anything but a "standard" HIPAA release. The "providers" identified in the release were not, in fact, health care providers, but rather were the Registered Representatives participating in Horowitz's scheme. Furthermore, in small boilerplate print, the release purported to authorize the Registered Representatives' use of the signing patient's ID and Health Data "in connection with" the sale of variable annuities. By its terms, the release further required the signing hospice patient to indemnify the Registered Representatives against all losses, claims or other damages incurred by the Registered Representatives resulting from the use of the hospice patients' ID and Health Data in the sale of variable annuities. This document did not, however, authorize the release of patient ID and Health Data to Berger or Flowers (who then provided Horowitz and/or his associates with patient ID and Health Data).

55. Flowers obtained signatures on these purported "releases" under false pretenses. For example, she told certain caregivers that the release was a "receipt" for the money being offered. In at least one instance, Flowers engaged in a "bait and switch." She first showed the patient's caregiver purported tax forms, which Flowers contended the caregiver needed to sign so that the parties making the charitable donation could obtain their tax write off. Flowers then shuffled the purported tax forms, replacing them with a copy of the release and signature pages from annuity applications, which the caregiver then unwittingly signed.

56. As the scheme evolved, Berger incorporated Patient Financial Services ("PFS"). Flowers provided certain hospice patients and their caregivers with a business card falsely identifying Flowers as a "Financial Consultant" for PFS. In fact, Flowers had no financial training and had never worked in the financial industry. Furthermore, Flowers did not understand what a variable annuity was and had no idea how it operated. She could not have explained the mechanics of a variable annuity to any of the patients or their caregivers.

57. Berger drafted a PFS brochure, which offered up to $5,000 to patients with "a terminal diagnosis [and]...a prognosis of between one and six months." Flowers and Health Care Provider 1 disseminated this brochure to hospice patients, health care providers and funeral homes. The PFS brochure failed to disclose that, in exchange for a monetary payment, patients would be asked to release their ID and Health Data to the Registered Representatives for use in the sale of variable annuities.

58. The PFS brochure further stated that: "As a participant, you will not be subject to any financial risk through this program." As Berger knew, or was reckless in not knowing, this assertion was false because the release the hospice patients or their caregivers were required to sign before receiving any donation required the signing patients to indemnify the Registered Representatives against any losses sustained in their use of the patient's ID and Health Data.

59. Horowitz instructed Respondent Flowers to fax him the signed releases and the patient's ID and Health Data as soon as possible. This was because the Registered Representatives wanted to sell variable annuities on the lives of the patients before they died. As the scheme evolved, Horowitz began instructing Flowers to send the releases to third parties working with him to facilitate annuities sales through other registered representatives.

60. Between November 2007 and February 2008, Berger and Flowers supplied Horowitz, or his associates, with the names and Id data of at least 10 terminally ill patients in Chicago. These patients were designated as annuitants in at least 7 variable annuities sold through Broker-Dealer 2, and in at least 34 variable annuities sold through Broker-Dealer 3.

61. Berger tracked the number of annuities sold on the lives of hospice patients whose ID and Health Data he and Flowers provided, and sought compensation from Horowitz and his associates based on the number of annuities sold.

62. Berger and Flowers continued to monitor the status of patients designated as annuitants until they died, often supplying Horowitz or his associates with real time reports on the patients' medical conditions. For instance, in April 2008, Berger provided the following update concerning patients who had been designated as annuitants:

> [Hospice Patient A] can be problematic. She was deteriorating at the point we signed her up but has shown signs of improvement since shes [sic] been on hospice. She is still on hospice but her prognosis cant [sic] be determined and it can take another 6 mos possibly.
>
> [Hospice Patient B] has been in and out of the hospital due to his COPD and is still very weak and on O2 will update when starts taking turn for worse

[Hospice Patient C] is on 100% O2 and is septic from her wounds and immune system is slowly shutting down. Her prognosis is very poor and doesn't have much time

[Hospice Patient D] has liver failure and it is untreatable. It is just a matter of time until it shuts down

[Hospice Patient E] has stage 4 lung cancer and is already non-verbal and deteriorating quickly.

All in all, based on the nurses assessments it seems that 3 of the patients are critical w/I the next month or 2, 1 is questionable based on the COPD and one may last longer than they thought....The shame in this is that all of these were the first round and as we learned the process better the more current ones are expiring quickly including those you were not able to process.

63. As part of their arrangement, when the patients died, Respondent Flowers obtained death certificates for the patients and provided them to the Registered Representatives or their associates so that they could file annuity death benefit claims on behalf of their customers.

64. Neither Berger nor Flowers has ever been registered with the Commission as a broker or dealer, or been an associated person of a registered broker or dealer. However, during the relevant period and based on the foregoing, Berger and Flowers were associated persons of Horowitz, who was acting as a broker, but who was not separately registered as a broker or dealer.

Ill-gotten Gains

65. Horowitz paid Respondent Ten at least $130,800 in exchange for the hospice patient ID and Health Data that Ten gave him, and which Horowitz needed to sell the stranger-owned variable annuities described above. Ten also earned net profits of at least $50,347 on the deferred variable annuity that he purchased on the life of Jane Doe.

66. Horowitz paid Berger $150,000 in exchange for the hospice and nursing home patient ID and Health Data that Respondents Berger and Flowers gave him, and which the Registered Representatives needed to sell the stranger-owned annuities described above. Of that amount, Berger kept at least $119,000. Flowers received and retained at least $11,000 from Berger in exchange for her role in the scheme.

VIOLATIONS

67. As a result of the conduct described above, Respondents Ten, Berger and Flowers 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.

68. As a result of the conduct described above, Respondents Ten, Berger and Flowers willfully aided and abetted and caused Horowitz's violations of 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.

Disgorgement and Civil Penalties

69. Respondent Flowers has submitted a sworn Statement of Financial Condition dated May 24, 2013, a sworn declaration dated October, 31, 2013, and other evidence, and has asserted her inability to pay disgorgement plus prejudgment interest and a civil penalty.

Undertakings

70. In connection with this proceeding and any related judicial or administrative action or investigation commenced by the Commission, or to which the Commission or The Division of Enforcement ("Division") is a party, Respondent Ten (i) agrees to appear and be interviewed by Division staff at such times and places as the staff requests upon reasonable notice; (ii) will produce all non-privileged documents and any other materials to the Division as requested by the Division's staff, wherever located, in the possession, custody, or control of the Respondent; (iii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission or the Division for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; and (iv) appoints Respondent Ten's attorney, John Potter, Esq. (of Quinn Emanuel, Urquhart & Sullivan, LLP, 50 California Street, 22nd Floor, San Francisco, CA 94111) as agent to receive service of such notices and subpoenas.

71. In connection with this proceeding and any related judicial or administrative action or investigation commenced by the Commission, or to which the Commission or the Division is a party, Respondent Berger (i) agrees to appear and be interviewed by Division staff at such times and places as the staff requests upon reasonable notice; (ii) will produce all non-privileged documents and any other materials to the Division as requested by the Division's staff, wherever located, in the possession, custody, or control of the Respondent; (iii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission or the Division for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; and (iv) appoints Respondent Berger's attorney, Gary Caplan, Esq. (of Reed Smith, LLP, 10 South Wacker Drive, 40th Floor, Chicago, IL 60606) as agent to receive service of such notices and subpoenas.

72. In connection with this proceeding and any related judicial or administrative action or investigation commenced by the Commission, or to which the Commission or the Division is a party, Respondent Flowers (i) agrees to appear and be interviewed by Division staff at such times and places as the staff requests upon reasonable notice; (ii) will produce all non-privileged documents and any other materials to the Division as requested by the Division's staff, wherever located, in the possession, custody, or control of the Respondent; (iii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission or the Division for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; and (iv) appoints Respondent Flowers' attorney,

Gary Caplan, Esq. (of Reed Smith, LLP, 10 South Wacker Drive, 40th Floor, Chicago, IL 60606) as agent to receive service of such notices and subpoenas.

In determining whether to accept the Offers, the Commission has considered these undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

Respondent Ten

A. Respondent Ten cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Ten 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; 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.

C. Any reapplication for association by Respondent Ten 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 Respondent Ten, 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 Ten shall pay disgorgement of $181,147.64, prejudgment interest of $20,858.80 and a civil money penalty in the amount of $90,000, for a total payment of $292,006.44, to the United States Treasury. Payment shall be made in the following installments: $146,003.44 to be paid within ten (10) days of the entry of this Order and $146,003 to be paid within three hundred and sixty (360) days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) 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

(2) 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 Harold Ten 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 Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

Respondent Berger

A. Respondent Berger cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Berger 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; 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.

C. Any reapplication for association by Respondent Berger 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 Berger shall pay disgorgement of $119,000, prejudgment interest of $11,579.61 and a civil penalty of $100,000, for a total payment of $230,579.61 to the United States Treasury. Payment shall be made in the following installments: $58,000.61 to be paid within ten (10) days of the entry of this Order and thereafter, quarterly payments of $43,144.75 to be made on the following dates: March 31, 2014; June 30, 2014; September 30, 2014 and December 31, 2014. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) 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
(2) 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 Menachem Berger 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 Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

Respondent Flowers

A. Respondent Flowers cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Flowers 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; 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.

C. Any reapplication for association by Respondent Flowers 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 Flowers shall pay disgorgement of $11,057 plus prejudgment interest of $978.49, but that payment of such amount is waived, and the Commission is not imposing a penalty against Respondent Flowers, based upon Respondent's sworn representations in her Statement of Financial Condition dated May 24, 2013, her sworn declaration dated October 31 2013 and other documents submitted to the Commission.

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 Flowers 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 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 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.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71717 / March 13, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15791

In the Matter of **LIONS GATE ENTERTAINMENT CORP.** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Lions Gate Entertainment Corp. ("Lions Gate," the "Company," or "Respondent").

II.

In anticipation of the institution of these proceedings, Lions Gate has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Lions Gate admits the facts contained in Annex A attached hereto, the Commission's jurisdiction over it, and the subject matter of these proceedings, and 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 Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

30 of 63

III.

On the basis of this Order and Respondent's Offer, and the facts contained in Annex A, the Commission finds[1] that:

1. On July 20, 2010 Lions Gate participated in an extraordinary three-part set of transactions which put over 16 million shares of the Company stock in the hands of a director friendly to the Company's management (collectively with his investment partnership, the "Friendly Director") as part of the Company's effort to defeat a hostile tender offer by a large shareholder (the "Shareholder"). The Lions Gate public filings failed to disclose material information about the transactions.

2. For at least a year before these transactions occurred, Lions Gate and the Shareholder had been locked in a battle for control of the Company. During this time, the Shareholder had made several tender offers and acquired over 37 percent of the outstanding stock of the Company. For its part, the Company believed that allowing the Shareholder to control the Company was not in the best interest of the Company and its shareholders and accordingly pursued a vigorous defense strategy to thwart the Shareholder's effort to take control of the Company, including an active campaign to discourage shareholders from tendering their stock to the Shareholder.

3. Lions Gate management knew that a large, direct sale of stock from the Company to the Friendly Director would advance management's strategy as it would put voting rights in the hands of someone supportive of management and dilute the percentage of ownership of those hostile to management. However, such a transaction, commonly known as a "defensive recapitalization," would have required prior approval from the Company's shareholders under a NYSE rule and was not practical given the time constraints the Company faced in defending against the Shareholder's takeover effort. In early July 2010, Lions Gate began to explore a three-part set of transactions involving a holder of Company notes convertible into stock (the "Note Holder"), the Friendly Director, and the Company. These transactions involved an exchange of the Note Holder's notes for new notes that could be converted to Lions Gate stock at a much more favorable rate; the sale of the new notes from the Note Holder to the Friendly Director; and the conversion of the new notes to Lions Gate stock by the Friendly Director. Lions Gate took the position that the sale of notes to the Friendly Director was not a related party transaction and, thus, did not require shareholder approval under the NYSE rule.

4. Facing the likelihood of a new tender offer from the Shareholder at an unknown price, on July 20, 2010, the Company's Board of Directors (the "Board") approved the exchange of convertible notes and, at the same time, agreed to loosen timing restrictions under its insider trading

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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.

policy to allow the Friendly Director to purchase the notes and convert them to Lions Gate stock.

5. When the Shareholder announced a new tender offer on the morning of July 20, the convertible notes already had been exchanged by the Note Holder. Later that morning, they were sold by the Note Holder to the Friendly Director who promptly converted the notes to stock. As a result of the transactions executed on July 20 (the "July 20 Transactions"), the Friendly Director obtained control of approximately 16 million shares, representing 9 percent of the Company's outstanding stock, effectively blocking the Shareholder's bid for control of the Company.

6. Later on July 20, Lions Gate issued a press release announcing the exchange and conversion of the notes, which was incorporated in a Form 8-K filed with the Commission. This press release stated only that the exchange and conversion was done for the purpose of reducing debt and improving near term liquidity, and failed to disclose that a purpose and expected effect of the July 20 Transactions was to fend off the Shareholder's takeover efforts, and that Lions Gate viewed that as a desirable benefit of the transactions. It also failed to disclose the steps Lions Gate took to incentivize the Friendly Director to purchase the notes and convert them to common stock.

7. After the July 20 Transactions, Lions Gate filed a Schedule 14D-9 with the Commission that stated that the note exchange was not part of a pre-arranged series of transactions to issue shares to the Friendly Director, but the Schedule 14D-9 failed to disclose details that would have demonstrated the extent to which Lions Gate planned and enabled the exchange of notes with the Note Holder and sale of the new notes to the Friendly Director. It also failed to disclose that a purpose and expected effect of the July 20 Transactions was to block the Shareholder's takeover efforts and that Lions Gate viewed that as a desirable benefit of the transactions. In addition, Lions Gate failed to include in its Schedule 14D-9 other required information concerning the Friendly Director's conversion of the notes to Lions Gate stock.

8. By engaging in the conduct described herein, Lions Gate violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-11 thereunder and Exchange Act Section 14(d) and Rule 14d-9 thereunder.

Respondent

9. Lions Gate is a corporation organized under the laws of the Province of British Columbia with its principal place of business in Santa Monica, California. It also has offices in New York, New York and Vancouver, British Columbia. At all relevant times, Lions Gate stock was registered pursuant to Section 12(b) of the Exchange Act [15 U.S.C. §78l(b)] and was listed on the New York Stock Exchange.

Battle for Control of Lions Gate

10. In 2008, the Shareholder began purchasing Lions Gate stock with the intent of gaining control of the Company and, by February 2009, he had acquired beneficial ownership of 14.28 percent of the outstanding shares of Lions Gate's stock. On February 25, 2009, the Shareholder demanded that the Board permit him to appoint individuals to fill up to 5 of the 12 seats on the Board. The Company refused his demand.

11. Between March 2009 and February 2010, the Shareholder continued his efforts to obtain Lions Gate common stock and, on February 5, 2010, disclosed that he beneficially owned 18 percent of the outstanding shares of Lions Gate's stock. Later that same month, the Shareholder presented the Company with a list of conditions that it had to accept to avoid a battle with him over control of the Company. Lions Gate rejected the Shareholder's conditions and, on February 26, 2010, Lions Gate formed a Special Committee of independent directors to oversee the Company's response to the Shareholder (the "Special Committee").

12. On March 1, 2010, the Shareholder made a tender offer of $6.00 per share for Lions Gate stock. The tender offer would give public shareholders a premium of 55 cents over the closing price of $5.45 on the date prior to the announcement of the offer. The offer was conditioned on several prospective events not occurring, including the issuance of new shares, and the adoption of a shareholder rights plan, commonly known as a "poison pill." On March 11, 2010, in response to this tender offer, Lions Gate adopted a poison pill to discourage the Shareholder's hostile takeover by making it more expensive to acquire control of the Company.

13. A day after adopting the poison pill, Lions Gate recommended shareholders not tender their shares to the Shareholder's March 1, 2010 tender offer. Between April and June, the Shareholder launched and extended additional offers for Lions Gate's shares. In response to each of the offers, Lions Gate recommended shareholders not tender their shares to the Shareholder, claiming, among other things, that the Shareholder's offers were inadequate, opportunistic, and coercive.

14. On June 11, 2010, the Shareholder issued a public letter to the Lions Gate Board accusing the Board of mismanagement and of trying to scare shareholders into not tendering their shares. The Shareholder continued his efforts to obtain control of Lions Gate through tender offers for the Company's stock and through private transactions.

15. In late June, the Vice Chairman of Lions Gate, who was also a member of the Board (the "Vice Chairman"), became aware that two large shareholders desired to sell their blocks of shares (each amounting to approximately 5 percent of outstanding shares). The Vice Chairman attempted to arrange for third parties sympathetic to Lions Gate's management to purchase the two blocks of shares. Third party investors who are sympathetic to management and willing to purchase minority stakes in a company in order to aid in the defense of a hostile takeover are commonly referred to as "white squires." One of the potential white squires for one of the two potential transactions was the Friendly Director. However, despite the Vice Chairman's efforts, the Shareholder ended up purchasing both blocks of stock. By July 1, 2010, the Shareholder had beneficial ownership of approximately 37.9 percent of the Company's outstanding shares.

Lions Gate's Convertible Notes Present an Opportunity To Make the Shareholder's Attempted Takeover More Difficult

16. In June 2010, a capital management company supportive of Lions Gate's management (the "Note Holder") held convertible notes issued by Lions Gate worth approximately $99.7 million. These notes were convertible to Lions Gate common stock at the option of the Note Holder and had approaching put dates of October 2011 and March 2012,

when they could be put to the Company at par value. It would have made no economic sense for the Note Holder to convert the notes to stock at that time since the then-current market price of Lions Gate's stock was less than the conversion price of the notes. For example, in July 2010, Lions Gate's two series of convertible notes held by the Note Holder had conversion prices of $14.28 and $11.50 per share while Lions Gate's stock was only trading at between $6 and $7 per share. Simply put, if the Note Holder wanted to increase the size of his Lions Gate stock holdings, it would have been considerably less expensive for the Note Holder to buy stock in the market than to convert the notes he owned to stock at those conversion rates. Buying stock in the market, however, would not have had a dilutive effect on the Shareholder, and, therefore, would not have advanced Lions Gate management's efforts to reduce the Shareholders' ownership stake in the Company.

17. On June 30, 2010, Lions Gate's Special Committee and Board met to discuss the Shareholder's efforts to gain control of the Company and, on that same day, the Vice Chairman spoke with the Note Holder about a possible exchange of the notes he held for newly issued notes of the same value, but with a conversion rate that would make converting the notes to common stock much more appealing. The Note Holder expressed interest in such an exchange.

18. Five days later, on July 4, in the course of negotiations with the Shareholder, the Vice Chairman wrote in an email to the Shareholder's financial adviser that Lions Gate would win the proxy fight and aggressively dilute the Shareholder. The next day, the Vice Chairman and the Friendly Director discussed a potential defensive recapitalization transaction through which the Friendly Director, acting as a white squire, would buy all the Note Holder's notes, which could be converted to Lions Gate stock at the stock's present market price. Three days later, on July 8, the Note Holder confirmed to the Vice Chairman that he was interested in exchanging all the Lions Gate notes he held for new notes with the more favorable conversion rate.

The Framework for the July 20 Transactions is Established Before A Standstill Agreement with the Shareholder Begins

19. By July 9, 2010, the Vice Chairman, in separate discussions with the Note Holder and the Friendly Director, had established the basic framework of the July 20 Transactions whereby: Lions Gate would first exchange the Note Holder's notes for new notes (the "Exchange"); the Note Holder would then sell the new notes—now convertible at market prices—to the Friendly Director at a premium (the "Note Sale"); and the Friendly Director would then convert the new notes to shares of Lions Gate stock (the "Conversion").

20. That same day, Lions Gate and the Shareholder entered into a ten-day standstill agreement in order to explore the possibility of a merger between Lions Gate and a movie production company. The standstill agreement, which was due to expire just after 11:59 p.m., July 19, 2010, precluded Lions Gate from negotiating transactions involving five percent or more of the outstanding shares of its stock and from arranging or encouraging others to do the same.

21. Lions Gate engaged in negotiations with the Note Holder and the Friendly Director. For example, on July 15, the Vice Chairman and the Friendly Director discussed a plan to increase the size of the Friendly Director's ownership interest through a series of text messages between the

two, in which the Friendly Director wrote: "Get me all and [the Shareholder] may leave. Its our only chance. I haven't been wrong yet about him. You have to trust me." The Vice Chairman replied: "Trying like hell."

22. That same day, an attorney for the law firm that was advising Lions Gate sent a preliminary term sheet for the Exchange to the Friendly Director's attorney. Three days later, on July 18, 2010, the Friendly Director's attorneys contacted the Note Holder and sent him a draft purchase agreement for the new Lions Gate notes, in which the purchase price was still blank.

23. The terms of the new note indentures and the Note Holder's "out of the money" notes were virtually identical, but included provisions designed to encourage the holder to immediately convert the notes to stock. For example, the new notes would convert at the market price of Lions Gate Stock rather than the "out of the money," above-market prices of the old notes. This provision approximately doubled the number of shares that would be obtained upon conversion. Also, the new note indentures did not contain restrictions in the old notes that precluded their conversion if the conversion resulted in the note holder owning more than 4.99 percent of the Company's outstanding stock. If this restriction had not been eliminated, the Friendly Director would have been unable to convert any portion of the notes to shares of Lions Gate stock because, in July 2010, the Friendly Director already was the beneficial owner of approximately 20 percent of Lions Gate's outstanding stock. The new conversion price was later calculated to be $6.32 per share. The expected effect of the July 20 Transactions was to increase the number of shares controlled by management and directors, thereby effectively blocking the Shareholder's takeover efforts.

24. Less than a week after the standstill agreement went into effect, the prospect of a merger between Lions Gate and another movie production company became virtually nonexistent. The Shareholder and the Vice Chairman blamed each other for its failure. The Shareholder threatened that he would launch an "any and all" tender offer to "finish [management] off," and the Vice Chairman replied that Lions Gate would issue stock and dilute the Shareholder's holdings.

25. Lions Gate scheduled a Special Committee meeting for 12:01 a.m. on July 20—one minute after the standstill agreement expired—with a Board meeting to immediately follow. The meeting was scheduled just after midnight so that Lions Gate's directors could potentially approve transactions with the Note Holder and Friendly Director involving more than five percent of the Company's outstanding shares without violating the standstill agreement with the Shareholder.

Lions Gate Agrees to a Last Minute Request by the Friendly Director to Change the Conversion Price

26. The Friendly Director negotiated the conversion price with the expectation that the Note Holder would sell him the notes. Late on the evening on July 19, before the scheduled Board meeting, the Friendly Director asked the Vice Chairman to lower the conversion price in the note exchange that Lions Gate had negotiated with the Note Holder from $6.32 to $6.20 per share. This change would result in the Friendly Director receiving an additional 305,000 shares upon conversion.

27. While the request for a lower conversion would also be advantageous to the Note Holder, as the initial recipient of the new notes, the Note Holder did not request this change. Rather, the lower conversion price was requested by the Friendly Director, who was the expected purchaser of the new notes.

The Board Meets at Midnight

28. At 12:01 a.m. New York time on July 20, 2010, one minute after the standstill agreement expired, the Special Committee convened a meeting and the Board met immediately afterwards. The Board first discussed the time period during which a director was precluded from trading Lions Gate stock and then voted to shorten it. Without this change, the Friendly Director would not have been able to convert the new notes to Lions Gate stock immediately after purchasing them from the Note Holder. The Vice Chairman then described the terms of the Exchange to the Board, including the Friendly Director's request just hours earlier for a lower conversion price. The Board approved the terms of the Exchange, including the Friendly Director's request to reduce the conversion price from $6.32 to $6.20 per share. According to the minutes of the meeting, the Board considered the dilutive effect of the transaction on the Shareholder's holdings (and those of other common shareholders) and determined that the transaction would be beneficial to shareholders generally.

The July 20 Transactions Are Completed

29. At 1:07 a.m. on July 20, the Note Holder's attorney sent wire transfer instructions to the Friendly Director's attorney for all the notes and specified the final sale price of $105,650,993. This price included a five percent premium over the face value of all the notes held by the Note Holder.

30. Approximately 40 minutes after the Note Holder sent wire transfer instructions to the Friendly Director for all his notes, Lions Gate asked the Note Holder's attorney if the Note Holder would be interested in exchanging all the notes he held. One minute later, the Note Holder's attorney said the Note Holder was "amenable" to that proposal.

31. By 4:00 a.m., Lions Gate and the Note Holder had signed the Exchange agreement. Although the change in the conversion price of the notes increased their value, the Note Holder did not demand more money from the Friendly Director. At 6:45 a.m., the Friendly Director's attorney emailed the Note Holder's attorney a revised purchase agreement and asked the Note Holder to sign the agreement and deliver the notes as soon as possible that morning.

32. At approximately 6:30 a.m., Lions Gate learned that the Shareholder made a new tender offer of $6.50 per share for all of Lions Gate's stock, and by 9:30 a.m., the Friendly Director had purchased the notes from the Note Holder. By afternoon, he had converted the new notes into 16,236,305 shares of Lions Gate stock at $6.20, representing approximately nine per cent of the outstanding shares of the Company's stock after the Conversion. As this conversion retired the new notes, it reduced Lions Gate's debt by $99 million.

33. The July 20 Transactions diluted the positions of all Lions Gate shareholders including the Shareholder who was seeking to gain control of the Company. As a result of the July

20 Transactions, the percentage of Lions Gate's outstanding stock held by the Shareholder decreased from 37.87 percent to 33.5 percent, while the percentage beneficially owned by the Friendly Director increased from 19.99 percent to 28.9 percent.

Lions Gate Files a Form 8-K That Omits Material Information Regarding the July 20 Transactions

34. On the afternoon of July 20, 2010, Lions Gate issued a press release announcing the Exchange and Conversion and incorporated the release in the July 20, 2010 Form 8-K the Company filed with the Commission.

35. The press release attached to the Form 8-K stated in part: "The [Exchange] is a key part of the Company's previously announced plan to reduce its total debt, as well as its nearer term maturities."

36. Although Lions Gate had consummated and publicly disclosed four debt-reduction transactions between December 2008 and December 2009, Lions Gate had never announced a plan to reduce total debt prior to issuing the press release on July 20, 2010. Contrary to the statement in the July 20 press release, Lions Gate's prior public filings stated:

a. the Company was likely to take on more debt;

b. Lions Gate's regular course of business in producing or making motion pictures was to take on debt to finance films;

c. most movies Lions Gate produced were financed with debt transactions; and

d. Lions Gate had raised over $224 million through the sale of high interest debt by October 27, 2009.

37. Neither the Form 8-K that Lions Gate filed nor the press release attached to it disclosed that:

a. Lions Gate management hoped and expected the July 20 Transactions to effectively block the Shareholder's takeover of the Company and that Lions Gate management viewed that as a desirable benefit of the transactions;

b. An investment partnership managed by the Friendly Director purchased and converted the new notes;

c. Lions Gate changed its insider trading policy to allow the Friendly Director to convert the notes; and

d. Lions Gate lowered the conversion price following discussions with the Friendly Director.

Lions Gate Fails to Disclose Material Information about the July 20 Transactions in its Schedule 14D-9, dated August 2, 2010

38. On August 2, 2010, Lions Gate filed a Schedule 14D-9 with the Commission (the "Original Schedule 14D-9"). In this filing, Lions Gate recommended that shareholders not tender their shares to the Shareholder's July 20 tender offer. In Item 6 of the Schedule 14D-9, Lions Gate listed recent securities transactions by some directors. The listed transactions totaled 2.5 million shares of Lions Gate stock and included individual transactions ranging from 17,000 to 350,000 shares each, with share prices from $6.70 to $6.98. However, the July 20 Transactions were not listed and Item 6 did not include the following required information:

a. the Friendly Director converted notes to Lions Gate stock;

b. the date of the conversion of the notes by the Friendly Director;

c. the $6.20 per share conversion price of the stock; or

d. the nature of the July 20 Transactions that resulted in the Friendly Director obtaining over 16 million shares of Lions Gate Stock.

39. Lions Gate did not include any of the required information about the July 20 Transactions in Item 6 of any of the subsequent twenty-two amendments to its Original Schedule 14D-9.

The New York Stock Exchange Raises Questions About the July 20 Transactions

40. On July 28, 2010, the NYSE contacted Lions Gate to inquire whether the July 20 Transactions may have violated Section 312.03(b) of the NYSE Listed Company Manual ("Section 312.03(b)"). Section 312.03(b) requires a company to obtain shareholder approval prior to the issuance of common stock and securities convertible into common stock to a director or to any company in which the director may have a substantial interest when the number of shares to be issued exceeds one percent of the shares of stock outstanding before the issuance. If the July 20 Transactions were a "related transaction" within the meaning of Section 312.03(b), Lions Gate would have been required to submit the July 20 Transactions to all its shareholders for approval prior to executing it—which it had not done. Lions Gate took the position that the transactions did not require a shareholder vote, which is required by a NYSE rule applicable to large transactions between NYSE-listed companies and related parties, including board members.

41. On or about September 7, 2010, Lions Gate provided NYSE a draft public disclosure concerning the nature of the July 20 Transactions. This disclosure included the representation that the Exchange of Notes—the first component of the July 20 Transactions—was not part of a "pre-arranged series of transactions to issue shares to [the Friendly Director]," but did not disclose other details about the exchange that would have demonstrated the extent to which Lions Gate enabled the exchange and sale of the notes.

Lions Gate Omits Material Information About the July 20 Transactions in its Third Amended Schedule 14D-9

42. In its response to the NYSE's inquiry, Lions Gate said it would disclose additional information in a publicly filed amendment to the Original Schedule 14D-9. On September 8, 2010, Lions Gate filed a Third Amended Schedule 14D-9 with the Commission that contained additional information about the July 20 Transactions.

43. In the Third Amended Schedule 14D-9, Lions Gate included a description of the July 20 Transactions. In this filing, Lions Gate stated that the "Exchange was not part of a pre-arranged series of transactions to issue shares to [the Friendly Director] . . . ." and failed to disclose key details about the July 20 Transactions that would have demonstrated the extent to which Lions Gate planned and enabled the Exchange of Notes with the Note Holder and Sale of the new notes to the Friendly Director, including the facts that:

a. The Board amended the Company's insider trading policy at the same board meeting in which it approved the July 20 Transactions to allow the Friendly Director to immediately convert the notes to stock;

b. The Board approved the Friendly Director's request to change the New Note conversion price although the change was not requested by the Note Holder; and

c. Lions Gate allowed the Friendly Director to review the New Note terms, term sheet, and exchange agreement before it provided them to the Note Holder.

44. Also, like the Original Schedule 14D-9 Lions Gate filed with the Commission, Item 6 of the Third Amended Schedule 14D-9 did not:

a. Disclose that the Friendly Director converted the notes to Lions Gate stock;

b. Disclose the date of the conversion of the notes by the Friendly Director;

c. Disclose the $6.20 per share conversion price of the stock; and

d. Describe the nature of the July 20 transaction that resulted in the Friendly Director obtaining over 16 million shares of Lions Gate Stock.

45. After filing the Third Amended Schedule 14D-9, Lions Gate filed eighteen additional amendments of the Original Schedule 14D-9 with the Commission that contained recommendations to investors to reject the Shareholder's tender offers. All of these amendments contained the statement that the "Exchange was not part of a prearranged series of transactions to issue shares to [the Friendly Director] . . . ." and all of them continued to omit the same information in Item 8 as the Third Amended Schedule 14D-9.

The July 20 Transactions Effectively Blocked The Shareholder's Attempt to Take Control of Lions Gate

46. At a shareholder's meeting on December 14, 2010, shareholders elected management's slate of directors and rejected the slate endorsed by the Shareholder. The margin of defeat for one of the five directors proposed by the Shareholder (who, if elected, would have occupied one of the Company's twelve board seats) was approximately 16 million shares—the same number of shares the Friendly Director obtained as a result of the July 20 Transactions.

47. As a result of the conduct described above, Lions Gate violated Sections 13(a) and 14(d) of the Exchange Act and Rules 12b-20, 13a-11, and 14d-9 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Lions Gate's offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Lions Gate cease and desist from committing or causing any violations and any future violations of Sections 13(a) and 14(d) of the Exchange Act and Rules 12b-20, 13a-11, and 14d-9 thereunder.

B. Lions Gate, shall, within ten (10) business days of the entry of this Order, pay a civil money penalty in the amount of $7,500,000 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 Lions Gate 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 Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

C. 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, Lions Gate 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 Lions Gate's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Lions Gate 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 Lions Gate 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.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

ANNEX A

Lions Gate Entertainment Corp. ("Lions Gate" or the "Company") admits to the facts set forth below and acknowledges that its conduct violated the federal securities laws:

1. On July 20, 2010 Lions Gate participated in an extraordinary three-part set of transactions which put over 16 million shares of the Company stock in the hands of a director friendly to the Company's management (collectively with his investment partnership, the "Friendly Director") as part of the Company's effort to defeat a hostile tender offer by a large shareholder (the "Shareholder"). The Lions Gate public filings failed to disclose material information about the transactions.

2. For at least a year before these transactions occurred, Lions Gate and the Shareholder had been locked in a battle for control of the Company. During this time, the Shareholder had made several tender offers and acquired over 37 percent of the outstanding stock of the Company. For its part, the Company believed that allowing the Shareholder to control the Company was not in the best interest of the Company and its shareholders and accordingly pursued a vigorous defense strategy to thwart the Shareholder's effort to take control of the Company, including an active campaign to discourage shareholders from tendering their stock to the Shareholder.

3. Lions Gate management knew that a large, direct sale of stock from the Company to the Friendly Director would advance management's strategy as it would put voting rights in the hands of someone supportive of management and dilute the percentage of ownership of those hostile to management. However, such a transaction, commonly known as a "defensive recapitalization," would have required prior approval from the Company's shareholders under a NYSE rule and was not practical given the time constraints the Company faced in defending against the Shareholder's takeover effort. In early July 2010, Lions Gate began to explore a three-part set of transactions involving a holder of Company notes convertible into stock (the "Note Holder"), the Friendly Director, and the Company. These transactions involved an exchange of the Note Holder's notes for new notes that could be converted to Lions Gate stock at a much more favorable rate; the sale of the new notes from the Note Holder to the Friendly Director; and the conversion of the new notes to Lions Gate stock by the Friendly Director. Lions Gate took the position that the sale of notes to the Friendly Director was not a related party transaction and, thus, did not require shareholder approval under the NYSE rule.

4. Facing the likelihood of a new tender offer from the Shareholder at an unknown price, on July 20, 2010, the Company's Board of Directors (the "Board") approved the exchange of convertible notes and, at the same time, agreed to loosen timing restrictions under its insider trading policy to allow the Friendly Director to purchase the notes and convert them to Lions Gate stock.

5. When the Shareholder announced a new tender offer on the morning of July 20, the convertible notes already had been exchanged by the Note Holder. Later that morning, they were sold by the Note Holder to the Friendly Director who promptly converted the notes to stock. As a result of the transactions executed on July 20 (the "July 20 Transactions"), the Friendly Director obtained control of approximately 16 million shares, representing 9 percent of the Company's

outstanding stock, effectively blocking the Shareholder's bid for control of the Company.

6. Later on July 20, Lions Gate issued a press release announcing the exchange and conversion of the notes, which was incorporated in a Form 8-K filed with the Commission. This press release stated only that the exchange and conversion was done for the purpose of reducing debt and improving near term liquidity, and failed to disclose that a purpose and expected effect of the July 20 Transactions was to fend off the Shareholder's takeover efforts, and that Lions Gate viewed that as a desirable benefit of the transactions. It also failed to disclose the steps Lions Gate took to incentivize the Friendly Director to purchase the notes and convert them to common stock.

7. After the July 20 Transactions, Lions Gate filed a Schedule 14D-9 with the Commission that stated that the note exchange was not part of a pre-arranged series of transactions to issue shares to the Friendly Director, but the Schedule 14D-9 failed to disclose details that would have demonstrated the extent to which Lions Gate planned and enabled the exchange of notes with the Note Holder and sale of the new notes to the Friendly Director. It also failed to disclose that a purpose and expected effect of the July 20 Transactions was to block the Shareholder's takeover efforts and that Lions Gate viewed that as a desirable benefit of the transactions. In addition, Lions Gate failed to include in its Schedule 14D-9 other required information concerning the Friendly Director's conversion of the notes to Lions Gate stock.

Respondent

8. Lions Gate is a corporation organized under the laws of the Province of British Columbia with its principal place of business in Santa Monica, California. It also has offices in New York, New York and Vancouver, British Columbia. At all relevant times, Lions Gate stock was registered pursuant to Section 12(b) of the Exchange Act [15 U.S.C. §78l(b)] and was listed on the New York Stock Exchange.

Battle for Control of Lions Gate

9. In 2008, the Shareholder began purchasing Lions Gate stock with the intent of gaining control of the Company and, by February 2009, he had acquired beneficial ownership of 14.28 percent of the outstanding shares of Lions Gate's stock. On February 25, 2009, the Shareholder demanded that the Board permit him to appoint individuals to fill up to 5 of the 12 seats on the Board. The Company refused his demand.

10. Between March 2009 and February 2010, the Shareholder continued his efforts to obtain Lions Gate common stock and, on February 5, 2010, disclosed that he beneficially owned 18 percent of the outstanding shares of Lions Gate's stock. Later that same month, the Shareholder presented the Company with a list of conditions that it had to accept to avoid a battle with him over control of the Company. Lions Gate rejected the Shareholder's conditions and, on February 26, 2010, Lions Gate formed a Special Committee of independent directors to oversee the Company's response to the Shareholder (the "Special Committee").

11. On March 1, 2010, the Shareholder made a tender offer of $6.00 per share for Lions Gate stock. The tender offer would give public shareholders a premium of 55 cents over the

closing price of $5.45 on the date prior to the announcement of the offer. The offer was conditioned on several prospective events not occurring, including the issuance of new shares, and the adoption of a shareholder rights plan, commonly known as a "poison pill." On March 11, 2010, in response to this tender offer, Lions Gate adopted a poison pill to discourage the Shareholder's hostile takeover by making it more expensive to acquire control of the Company.

12. A day after adopting the poison pill, Lions Gate recommended shareholders not tender their shares to the Shareholder's March 1, 2010 tender offer. Between April and June, the Shareholder launched and extended additional offers for Lions Gate's shares. In response to each of the offers, Lions Gate recommended shareholders not tender their shares to the Shareholder, claiming, among other things, that the Shareholder's offers were inadequate, opportunistic, and coercive.

13. On June 11, 2010, the Shareholder issued a public letter to the Lions Gate Board accusing the Board of mismanagement and of trying to scare shareholders into not tendering their shares. The Shareholder continued his efforts to obtain control of Lions Gate through tender offers for the Company's stock and through private transactions.

14. In late June, the Vice Chairman of Lions Gate, who was also a member of the Board (the "Vice Chairman"), became aware that two large shareholders desired to sell their blocks of shares (each amounting to approximately 5 percent of outstanding shares). The Vice Chairman attempted to arrange for third parties sympathetic to Lions Gate's management to purchase the two blocks of shares. Third party investors who are sympathetic to management and willing to purchase minority stakes in a company in order to aid in the defense of a hostile takeover are commonly referred to as "white squires." One of the potential white squires for one of the two potential transactions was the Friendly Director. However, despite the Vice Chairman's efforts, the Shareholder ended up purchasing both blocks of stock. By July 1, 2010, the Shareholder had beneficial ownership of approximately 37.9 percent of the Company's outstanding shares.

Lions Gate's Convertible Notes Present an Opportunity To Make the Shareholder's Attempted Takeover More Difficult

15. In June 2010, a capital management company supportive of Lions Gate's management (the "Note Holder") held convertible notes issued by Lions Gate worth approximately $99.7 million. These notes were convertible to Lions Gate common stock at the option of the Note Holder and had approaching put dates of October 2011 and March 2012, when they could be put to the Company at par value. It would have made no economic sense for the Note Holder to convert the notes to stock at that time since the then-current market price of Lions Gate's stock was less than the conversion price of the notes. For example, in July 2010, Lions Gate's two series of convertible notes held by the Note Holder had conversion prices of $14.28 and $11.50 per share while Lions Gate's stock was only trading at between $6 and $7 per share. Simply put, if the Note Holder wanted to increase the size of his Lions Gate stock holdings, it would have been considerably less expensive for the Note Holder to buy stock in the market than to convert the notes he owned to stock at those conversion rates. Buying stock in the market, however, would not have had a dilutive effect on the Shareholder, and, therefore, would not have advanced Lions Gate management's efforts to reduce the Shareholders' ownership stake in the

Company.

16. On June 30, 2010, Lions Gate's Special Committee and Board met to discuss the Shareholder's efforts to gain control of the Company and, on that same day, the Vice Chairman spoke with the Note Holder about a possible exchange of the notes he held for newly issued notes of the same value, but with a conversion rate that would make converting the notes to common stock much more appealing. The Note Holder expressed interest in such an exchange.

17. Five days later, on July 4, in the course of negotiations with the Shareholder, the Vice Chairman wrote in an email to the Shareholder's financial adviser that Lions Gate would win the proxy fight and aggressively dilute the Shareholder. The next day, the Vice Chairman and the Friendly Director discussed a potential defensive recapitalization transaction through which the Friendly Director, acting as a white squire, would buy all the Note Holder's notes, which could be converted to Lions Gate stock at the stock's present market price. Three days later, on July 8, the Note Holder confirmed to the Vice Chairman that he was interested in exchanging all the Lions Gate notes he held for new notes with the more favorable conversion rate.

The Framework for the July 20 Transactions is Established Before A Standstill Agreement with the Shareholder Begins

18. By July 9, 2010, the Vice Chairman, in separate discussions with the Note Holder and the Friendly Director, had established the basic framework of the July 20 Transactions whereby: Lions Gate would first exchange the Note Holder's notes for new notes (the "Exchange"); the Note Holder would then sell the new notes—now convertible at market prices—to the Friendly Director at a premium (the "Note Sale"); and the Friendly Director would then convert the new notes to shares of Lions Gate stock (the "Conversion").

19. That same day, Lions Gate and the Shareholder entered into a ten-day standstill agreement in order to explore the possibility of a merger between Lions Gate and a movie production company. The standstill agreement, which was due to expire just after 11:59 p.m., July 19, 2010, precluded Lions Gate from negotiating transactions involving five percent or more of the outstanding shares of its stock and from arranging or encouraging others to do the same.

20. Lions Gate engaged in negotiations with the Note Holder and the Friendly Director. For example, on July 15, the Vice Chairman and the Friendly Director discussed a plan to increase the size of the Friendly Director's ownership interest through a series of text messages between the two, in which the Friendly Director wrote: "Get me all and [the Shareholder] may leave. Its our only chance. I haven't been wrong yet about him. You have to trust me." The Vice Chairman replied: "Trying like hell."

21. That same day, an attorney for the law firm that was advising Lions Gate sent a preliminary term sheet for the Exchange to the Friendly Director's attorney. Three days later, on July 18, 2010, the Friendly Director's attorneys contacted the Note Holder and sent him a draft purchase agreement for the new Lions Gate notes, in which the purchase price was still blank.

22. The terms of the new note indentures and the Note Holder's "out of the money" notes were virtually identical, but included provisions designed to encourage the holder to

immediately convert the notes to stock. For example, the new notes would convert at the market price of Lions Gate Stock rather than the "out of the money," above-market prices of the old notes. This provision approximately doubled the number of shares that would be obtained upon conversion. Also, the new note indentures did not contain restrictions in the old notes that precluded their conversion if the conversion resulted in the note holder owning more than 4.99 percent of the Company's outstanding stock. If this restriction had not been eliminated, the Friendly Director would have been unable to convert any portion of the notes to shares of Lions Gate stock because, in July 2010, the Friendly Director already was the beneficial owner of approximately 20 percent of Lions Gate's outstanding stock. The new conversion price was later calculated to be $6.32 per share. The expected effect of the July 20 Transactions was to increase the number of shares controlled by management and directors, thereby effectively blocking the Shareholder's takeover efforts.

23. Less than a week after the standstill agreement went into effect, the prospect of a merger between Lions Gate and another movie production company became virtually nonexistent. The Shareholder and the Vice Chairman blamed each other for its failure. The Shareholder threatened that he would launch an "any and all" tender offer to "finish [management] off," and the Vice Chairman replied that Lions Gate would issue stock and dilute the Shareholder's holdings.

24. Lions Gate scheduled a Special Committee meeting for 12:01 a.m. on July 20—one minute after the standstill agreement expired—with a Board meeting to immediately follow. The meeting was scheduled just after midnight so that Lions Gate's directors could potentially approve transactions with the Note Holder and Friendly Director involving more than five percent of the Company's outstanding shares without violating the standstill agreement with the Shareholder.

Lions Gate Agrees to a Last Minute Request by the Friendly Director to Change the Conversion Price

25. The Friendly Director negotiated the conversion price with the expectation that the Note Holder would sell him the notes. Late on the evening on July 19, before the scheduled Board meeting, the Friendly Director asked the Vice Chairman to lower the conversion price in the note exchange that Lions Gate had negotiated with the Note Holder from $6.32 to $6.20 per share. This change would result in the Friendly Director receiving an additional 305,000 shares upon conversion.

26. While the request for a lower conversion would also be advantageous to the Note Holder, as the initial recipient of the new notes, the Note Holder did not request this change. Rather, the lower conversion price was requested by the Friendly Director, who was the expected purchaser of the new notes.

The Board Meets at Midnight

27. At 12:01 a.m. New York time on July 20, 2010, one minute after the standstill agreement expired, the Special Committee convened a meeting and the Board met immediately afterwards. The Board first discussed the time period during which a director was precluded from trading Lions Gate stock and then voted to shorten it. Without this change, the Friendly Director

would not have been able to convert the new notes to Lions Gate stock immediately after purchasing them from the Note Holder. The Vice Chairman then described the terms of the Exchange to the Board, including the Friendly Director's request just hours earlier for a lower conversion price. The Board approved the terms of the Exchange, including the Friendly Director's request to reduce the conversion price from $6.32 to $6.20 per share. According to the minutes of the meeting, the Board considered the dilutive effect of the transaction on the Shareholder's holdings (and those of other common shareholders) and determined that the transaction would be beneficial to shareholders generally.

The July 20 Transactions Are Completed

28. At 1:07 a.m. on July 20, the Note Holder's attorney sent wire transfer instructions to the Friendly Director's attorney for all the notes and specified the final sale price of $105,650,993. This price included a five percent premium over the face value of all the notes held by the Note Holder.

29. Approximately 40 minutes after the Note Holder sent wire transfer instructions to the Friendly Director for all his notes, Lions Gate asked the Note Holder's attorney if the Note Holder would be interested in exchanging all the notes he held. One minute later, the Note Holder's attorney said the Note Holder was "amenable" to that proposal.

30. By 4:00 a.m., Lions Gate and the Note Holder had signed the Exchange agreement. Although the change in the conversion price of the notes increased their value, the Note Holder did not demand more money from the Friendly Director. At 6:45 a.m., the Friendly Director's attorney emailed the Note Holder's attorney a revised purchase agreement and asked the Note Holder to sign the agreement and deliver the notes as soon as possible that morning.

31. At approximately 6:30 a.m., Lions Gate learned that the Shareholder made a new tender offer of $6.50 per share for all of Lions Gate's stock, and by 9:30 a.m., the Friendly Director had purchased the notes from the Note Holder. By afternoon, he had converted the new notes into 16,236,305 shares of Lions Gate stock at $6.20, representing approximately nine per cent of the outstanding shares of the Company's stock after the Conversion. As this conversion retired the new notes, it reduced Lions Gate's debt by $99 million.

32. The July 20 Transactions diluted the positions of all Lions Gate shareholders including the Shareholder who was seeking to gain control of the Company. As a result of the July 20 Transactions, the percentage of Lions Gate's outstanding stock held by the Shareholder decreased from 37.87 percent to 33.5 percent, while the percentage beneficially owned by the Friendly Director increased from 19.99 percent to 28.9 percent.

Lions Gate Files a Form 8-K That Omits Material Information Regarding the July 20 Transactions

33. On the afternoon of July 20, 2010, Lions Gate issued a press release announcing the Exchange and Conversion and incorporated the release in the July 20, 2010 Form 8-K the Company filed with the Commission.

34. The press release attached to the Form 8-K stated in part: "The [Exchange] is a key part of the Company's previously announced plan to reduce its total debt, as well as its nearer term maturities."

35. Although Lions Gate had consummated and publicly disclosed four debt-reduction transactions between December 2008 and December 2009, Lions Gate had never announced a plan to reduce total debt prior to issuing the press release on July 20, 2010. Contrary to the statement in the July 20 press release, Lions Gate's prior public filings stated:

e. the Company was likely to take on more debt;

f. Lions Gate's regular course of business in producing or making motion pictures was to take on debt to finance films;

g. most movies Lions Gate produced were financed with debt transactions; and

h. Lions Gate had raised over $224 million through the sale of high interest debt by October 27, 2009.

36. Neither the Form 8-K that Lions Gate filed nor the press release attached to it disclosed that:

e. Lions Gate management hoped and expected the July 20 Transactions to effectively block the Shareholder's takeover of the Company and that Lions Gate management viewed that as a desirable benefit of the transactions;

f. An investment partnership managed by the Friendly Director purchased and converted the new notes;

g. Lions Gate changed its insider trading policy to allow the Friendly Director to convert the notes; and

h. Lions Gate lowered the conversion price following discussions with the Friendly Director.

Lions Gate Fails to Disclose Material Information about the July 20 Transactions in its Schedule 14D-9, dated August 2, 2010

37. On August 2, 2010, Lions Gate filed a Schedule 14D-9 with the Commission (the "Original Schedule 14D-9"). In this filing, Lions Gate recommended that shareholders not tender their shares to the Shareholder's July 20 tender offer. In Item 6 of the Schedule 14D-9, Lions Gate listed recent securities transactions by some directors. The listed transactions totaled 2.5 million shares of Lions Gate stock and included individual transactions ranging from 17,000 to 350,000 shares each, with share prices from $6.70 to $6.98. However, the July 20 Transactions were not listed and Item 6 did not include the following required information:

e. the Friendly Director converted notes to Lions Gate stock;

f. the date of the conversion of the notes by the Friendly Director;

g. the $6.20 per share conversion price of the stock; or

h. the nature of the July 20 Transactions that resulted in the Friendly Director obtaining over 16 million shares of Lions Gate Stock.

38. Lions Gate did not include any of the required information about the July 20 Transactions in Item 6 of any of the subsequent twenty-two amendments to its Original Schedule 14D-9.

The New York Stock Exchange Raises Questions About the July 20 Transactions

39. On July 28, 2010, the NYSE contacted Lions Gate to inquire whether the July 20 Transactions may have violated Section 312.03(b) of the NYSE Listed Company Manual ("Section 312.03(b)"). Section 312.03(b) requires a company to obtain shareholder approval prior to the issuance of common stock and securities convertible into common stock to a director or to any company in which the director may have a substantial interest when the number of shares to be issued exceeds one percent of the shares of stock outstanding before the issuance. If the July 20 Transactions were a "related transaction" within the meaning of Section 312.03(b), Lions Gate would have been required to submit the July 20 Transactions to all its shareholders for approval prior to executing it—which it had not done. Lions Gate took the position that the transactions did not require a shareholder vote, which is required by a NYSE rule applicable to large transactions between NYSE-listed companies and related parties, including board members.

40. On or about September 7, 2010, Lions Gate provided NYSE a draft public disclosure concerning the nature of the July 20 Transactions. This disclosure included the representation that the Exchange of Notes—the first component of the July 20 Transactions—was not part of a "pre-arranged series of transactions to issue shares to [the Friendly Director]," but did not disclose other details about the exchange that would have demonstrated the extent to which Lions Gate enabled the exchange and sale of the notes.

Lions Gate Omits Material Information About the July 20 Transactions in its Third Amended Schedule 14D-9

41. In its response to the NYSE's inquiry, Lions Gate said it would disclose additional information in a publicly filed amendment to the Original Schedule 14D-9. On September 8, 2010, Lions Gate filed a Third Amended Schedule 14D-9 with the Commission that contained additional information about the July 20 Transactions.

42. In the Third Amended Schedule 14D-9, Lions Gate included a description of the July 20 Transactions. In this filing, Lions Gate stated that the "Exchange was not part of a pre-arranged series of transactions to issue shares to [the Friendly Director] . . . ." and failed to disclose key details about the July 20 Transactions that would have demonstrated the extent to which Lions Gate planned and enabled the Exchange of Notes with the Note Holder and Sale of the new notes to the Friendly Director, including the facts that:

d. The Board amended the Company's insider trading policy at the same board meeting in which it approved the July 20 Transactions to allow the Friendly Director to immediately convert the notes to stock;

e. The Board approved the Friendly Director's request to change the New Note conversion price although the change was not requested by the Note Holder; and

f. Lions Gate allowed the Friendly Director to review the New Note terms, term sheet, and exchange agreement before it provided them to the Note Holder.

43. Also, like the Original Schedule 14D-9 Lions Gate filed with the Commission, Item 6 of the Third Amended Schedule 14D-9 did not:

e. Disclose that the Friendly Director converted the notes to Lions Gate stock;

f. Disclose the date of the conversion of the notes by the Friendly Director;

g. Disclose the $6.20 per share conversion price of the stock; and

h. Describe the nature of the July 20 transaction that resulted in the Friendly Director obtaining over 16 million shares of Lions Gate Stock.

44. After filing the Third Amended Schedule 14D-9, Lions Gate filed eighteen additional amendments of the Original Schedule 14D-9 with the Commission that contained recommendations to investors to reject the Shareholder's tender offers. All of these amendments contained the statement that the "Exchange was not part of a prearranged series of transactions to issue shares to [the Friendly Director] . . . ." and all of them continued to omit the same information in Item 8 as the Third Amended Schedule 14D-9.

The July 20 Transactions Effectively Blocked The Shareholder's Attempt to Take Control of Lions Gate

45. At a shareholder's meeting on December 14, 2010, shareholders elected management's slate of directors and rejected the slate endorsed by the Shareholder. The margin of defeat for one of the five directors proposed by the Shareholder (who, if elected, would have occupied one of the Company's twelve board seats) was approximately 16 million shares—the same number of shares the Friendly Director obtained as a result of the July 20 Transactions.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 14, 2014

In the Matter of **Petrotech Oil & Gas, 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 Petrotech Oil & Gas, Inc. because of questions regarding the accuracy of publicly available information about the company's operations.

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

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on March 14, 2014, through 11:59 p.m. EDT on March 27, 2014.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71724 / March 14, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15793

IN THE MATTER OF **FRANK I. REINSCHREIBER,** **RESPONDENT.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Frank I. Reinschreiber ("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 them and the subject matter of these proceedings and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. During the relevant period Respondent Frank I. Reinschreiber ("Reinschreiber") was a principal of Global Financial Management, LLC ("Global Financial"), through which he acted as an escrow agent for several of the issuers of stock sold through an alleged boiler room scheme. Global Financial's website stated that Reinschreiber had thirty years of experience in accounting, tax and financial planning, and was formerly the CFO of A-Street Capital. According to CRD records, during the relevant period Reinschreiber was not associated with a registered broker-dealer. Reinschreiber is a resident of Chicago.

2. Global Financial, during the relevant time period, was an Illinois corporation based in Chicago. On its website, Global Financial portrayed itself as a "finance management company" offering "a complete line of escrow services including the ability to receive and send funds in any foreign currency." Respondent Reinschreiber was one of two individuals who controlled Global Financial, which acted as an escrow agent for several of the issuers of stock sold through the boiler room scheme. Global Financial is not registered with the Commission as a broker-dealer.

3. On February 21, 2014, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Section 15(a) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 77o(a)], in the civil action entitled Securities and Exchange Commission v. Philip T. Powers, et al., Civil Action Number 09-CV-676, in the United States District Court for the Northern District of Illinois.

4. The Commission's complaint alleges that the Respondent violated Section 15(a) of the Securities Exchange Act of 1934 by failing to register with the Commission as a broker or dealer. It is alleged that the Respondent acted as an escrow agent for the issuers of "penny stock" securities sold through a boiler room scheme, and received transaction based compensation for serving as escrow agent. It is further alleged that as escrow agent, the Respondent received the funds from allegedly defrauded investors, and disbursed the funds in accordance with distribution and escrow agreements. The Complaint also alleges that the Respondent's distribution of funds resulted in more than 60% of the proceeds being paid to distribution agents, foreign boiler room operators and to himself and Global Financial, with less than 40% paid to the issuer companies.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Frank I. Reinschreiber 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 with the right to apply for reentry after three years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71729 / March 14, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15795

In the Matter of **RICHARD P. GREENE, Esq.,** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Richard P. Greene pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. Section 201.102(e)(2)].[1]

II.

The Commission finds that:

1. Greene is an attorney, whom the State of Florida admitted to practice law in 1985. In 2003, Green was convicted of securities fraud in the United States District Court for the Southern District of Florida and, as a result, was disbarred effective April 2004. In 2011, Greene became eligible to apply for reinstatement to the Florida Bar but he has not yet sought it.

2. On January 15, 2014, a judgment of conviction was entered against Greene in *United States v. Greene, et al*, No. 13-cr-60203-KAM, in the United States District Court for the Southern District of Florida, finding him guilty of one count of conspiracy to commit securities fraud, in violation of Title 18, United States Code, Section 371. Greene pled guilty to participating in a scheme to manipulate the price and trading volume of VDO-PH International, Inc.

3. As a result of this conviction, Greene was sentenced to 18 months imprisonment in a federal penitentiary.

[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."

III.

In view of the foregoing, the Commission finds that Greene is a person who 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 Richard P. Greene 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71732 / March 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15796

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Gary Allen Cabello ("Cabello" 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, 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, 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. Cabello, age 55, is a resident of Westminster, California. From 1993 to 2013, Cabello worked as a registered representative in the securities industry, during which time he was associated with a number of broker-dealers registered with the Commission. From January 2006 until July 2010, Cabello was associated with Alta Vista Financial, Inc. ("AVF"), a broker-

dealer formerly registered with the Commission. He holds Series 7, 24, and 63 securities licenses.

2. On October 23, 2013, Cabello entered a plea of guilty in the Superior Court of California, County of San Diego to two felony counts of conspiracy to commit bribery in violation of California Penal Code Section 182(a)(1) in the cases filed as People v. Alioto, Case Nos. SCD235444, SCD235445 (Cal. Super. Ct. Dec. 21, 2012). In an addendum to his guilty plea, Cabello admitted that he conspired with the intent to commit bribery in violation of California Education Code Sections 35230 and 72530.

3. In the addendum to his guilty plea, Cabello admitted that he unlawfully conspired to commit bribery by providing things of value to officials of Sweetwater Union High School District ("Sweetwater") in return for decisions favoring his then-employer, AVF. Specifically, Cabello hosted one or more dinners and/or offered one or more valuable things to one or more members of Sweetwater's governing board, including meals and tickets to professional sporting events. In addition, according to the addendum to his guilty plea, Cabello admitted that he unlawfully conspired to commit bribery by providing things of value to officials of Southwestern Community College District ("Southwestern") in return for decisions favoring his then-employer, AVF. Specifically, Cabello hosted one or more dinners and/or offered one or more valuable things to one or more members of Southwestern's governing board, including a dinner at a New York City restaurant.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Cabello be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71734 / March 18, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3797 / March 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15797

In the Matter of

MICHAEL AARON BRADY,

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 Michael Aaron Brady ("Brady" 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, 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

35 of 63

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. Brady was the founder and sole member of A+ Financial Services, LLC ("A+ Financial"), a financial services entity and unregistered investment adviser. From March 1999 through March 2010, Brady was also a registered representative associated with broker-dealers registered with the Commission. Brady, 39 years old, is a resident of Newington, Connecticut.

2. On December 15, 2011, Brady pled guilty to one count of mail fraud in violation of Title 18 United States Code, Section 1341, before the United States District Court for the District of Connecticut in *United States of America v. Michael Brady*, Crim. Information No. 3:11-CR-00246-JBA. On May 24, 2012, a judgment in the criminal case was entered against Brady. He was sentenced to a prison term of 36 months, followed by three years of supervised release, and ordered to make restitution in the amount of $136,374.90.

3. The count of the criminal information to which Brady pled guilty alleged, *inter alia,* that between approximately January 2008 and approximately March 2010, Brady defrauded investors by soliciting client funds for investment and then converting the funds for his own personal use.

4. In connection with that plea, Respondent admitted that:

   a) On or about January 24, 2008, Brady faxed blank forms to a client in order for the client to open an investment account with Brady, who purported to act as the investment adviser on the client's account;
   b) On or about March 4, 2008, at Brady's direction, the client obtained a cashier's check in the amount of $56,625.39 payable to A+ Financial and mailed that check to Brady to invest. Instead of investing the money, Brady converted the proceeds of that check to his own personal use;
   c) In or around January 2010, Brady mailed a fictitious retirement account statement to the client purporting to show the status of the client's investment account. In fact, there was no such account because Brady had used the client's money for his own benefit; and
   d) The total loss for the client and other victims of the mail fraud scheme that forms the basis of the Information is $195,424.81.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Brady'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 Brady be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Piwowar Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71738 / March 18, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3798 / March 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15799

In the Matter of MICHAEL D. MONTGOMERY, 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, 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") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Michael D. Montgomery ("Respondent" or "Montgomery").

II.

After an investigation, the Division of Enforcement alleges that:

1. From June 2002 through July 2009, Montgomery was a registered representative of, and person associated with, Wachovia Securities Financial Network, LLC, a broker-dealer and investment adviser registered with the Commission, and Mutual Service Corporation, a broker-dealer and investment adviser registered with the Commission. Montgomery, age 44, is presently incarcerated at the United States Penitentiary Administrative Maximum Facility in Florence, Colorado.

2. In March 2011, Montgomery was indicted on six counts of wire fraud and four counts of filing a false tax return. The indictment charged that from 2003 to 2007, while acting as an elderly client's investment adviser, attorney-in-fact, and trustee of that client's revocable living trust, and after his client was placed in a nursing home, Montgomery stole over $1 million from the client's banking and investment accounts, routinely liquidated the client's securities and transferred the proceeds to himself, and created false "notes" and "loan papers" to conceal his theft. Montgomery also filed false income tax returns in which he omitted the income he received and took by theft from his client.

3. In June 2012, Montgomery pled guilty to two counts of the ten-count indictment, and on December 27, 2012, Montgomery was convicted of wire fraud in violation of 18 U.S.C. § 1343, and filing a false tax return in violation of 21 U.S.C. § 7206(1) before the United States District Court for the Western District of Washington, in United States v. Michael D. Montgomery, Case No. 3:11CR05156-RJB. He was sentenced to a prison term of 60 months followed by three years of supervised release. On January 25, 2013, the judgment was amended and Montgomery was also ordered to make restitution in the amount of $995,811.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

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

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 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.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71737 / March 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15179

In the Matter of **Linda Dianne Alexander,** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS**

I.

On January 17, 2013, the Securities and Exchange Commission ("Commission"), deeming it appropriate and in the public interest, instituted these public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Linda Dianne Alexander ("Alexander" or "Respondent").

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 her and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order 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. On December 6, 2012, an Order of Permanent Injunction was entered by consent against Alexander, permanently enjoining her from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, 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. Dianne Alexander, et al., Civil Action Number 1:12-CV-4028, in the United States District Court for the Northern District of Georgia.

2. The Commission's complaint alleges that, since at least 2004 Alexander has been conducting a Prime Bank-type investment fraud. The scheme involves the offer and sale of over $15 million of securities in an unregistered offering to more than 220 investors and prospective investors in Georgia and at least 20 other states. The securities are in the form of investments in a purportedly highly clandestine Trust based in Europe that purportedly has the power to create money through fractional banking and bank debentures. Investors allegedly loan money to the Trust for automatically renewable terms of one year and one day, in exchange for 38 percent annual interest. Investors must follow the Trust's strict rules to participate in the investment. Among other things, investors must keep the Trust a secret and, if they request a return of their principal, they are banned from further participation in the Trust. The complaint further alleges that Alexander knowingly or recklessly made material misrepresentations and omissions of fact to investors and prospective investors concerning, among other things, the expected returns, the use of investor funds, and investment risks, and engaged in conduct which operated as a fraud and deceit on investors. The complaint further alleges that Alexander conducted an unregistered offering of securities and acted as an unregistered broker-dealer.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Alexander be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; and
>
> 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, any 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 Respondent, whether or not the Commission had 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71739 / March 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15800

In the Matter of **Bristol Rhace Natural Resource Corp.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Bristol Rhace Natural Resource Corp. ("Bristol Rhace" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. Bristol Rhace (CIK No. 1502656) is a Delaware corporation located in Manson, Iowa with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g).

2. Bristol Rhace has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2012, which reported a net loss of $47,840 for the prior six months.

IV.

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

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

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71740 / March 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15801

In the Matter of **First State Bancorporation,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against First State Bancorporation ("First State" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. First State (CIK No. 897861) is a New Mexico corporation located in Albuquerque, New Mexico with a class of securities registered with the Commission

pursuant to Exchange Act Section 12(g). As of October 22, 2013, the company's stock (symbol "FSNMQ") 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). On April 27, 2011, First State filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of New Mexico, which was still pending as of November 24, 2013.

2. First State has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2010.

IV.

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

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

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71741 / March 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15802

In the Matter of **Tarcon Acquisitions I, Inc.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Tarcon Acquisitions I, Inc. ("Tarcon" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. Tarcon (CIK No. 1510839) is a revoked Nevada corporation located in Uniondale, New York. At all times relevant to this proceeding, the securities of Tarcon have been registered under Exchange Act Section 12(g).

2. Tarcon has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012.

IV.

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

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

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. 33-9562; 34-71742; IA-3799; File No. 4-673]

Cybersecurity Roundtable

AGENCY: Securities and Exchange Commission

ACTION: Notice of roundtable discussion; request for comment.

SUMMARY: The Securities and Exchange Commission will host a cybersecurity roundtable. Roundtable panelists will discuss the cybersecurity landscape and cybersecurity issues faced by exchanges and other key market systems, broker-dealers, investment advisers, transfer agents, and public companies. Panelists also will be invited to discuss industry and public-private sector coordination efforts relating to assessing and responding to cybersecurity issues.

The roundtable discussion will be held in the auditorium of the Securities and Exchange Commission headquarters at 100 F Street, NE, Washington DC on March 26, 2014 from 9:30 a.m. to approximately 3:00 p.m. The public is invited to observe the roundtable discussion. Seating will be available on a first-come, first-serve basis. The roundtable discussion will also be available via webcast on the Commission's website at www.sec.gov.

DATES: The roundtable discussion will take place on March 26, 2014. The Commission will accept comments regarding issues addressed at the roundtable until May 2, 2014.

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

Electronic Comments:

- Use the Commission's internet comment form (http://sec.gov/rules/other.shtml); or
- Send an email to rule-comments@sec.gov. Please include File Number 4-673 on the subject line.

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71743 / March 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15803

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

I.

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

II.

In anticipation 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, 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. First Financial LLC ("First Financial") was a Connecticut limited liability company with a principal place of business in Branford, Connecticut. Between 2003 and September 2012, First Financial operated as an unregistered broker-dealer by offering and selling interests in a pooled investment account directed by Sharif that traded in commodity futures. Sharif owned and operated First Financial throughout the relevant period of time.

2. On August 27, 2013, Sharif pled guilty in the United States District Court for the District of Connecticut to one count of violating Title 7, United States Code, Sections 6o(1) and 13(a)(2) (fraud by a commodity pool operator) and one count of violating Title 18, United States Code, Section 1343 (wire fraud), in a criminal action entitled United States of America v. Feisal Sharif, Case No. 3:13-cr-00172-SRU.

3. In connection with his guilty plea, Sharif admitted, inter alia, that, between 2003 and September 2012, he solicited millions of dollars from investors through First Financial by representing to them that he would pool their funds in an investment account that he operated for the purpose of trading in commodity futures, and by providing them with investment contracts that falsely reflected the pool had generated returns in prior years. Sharif admitted that he deposited and traded only a small percentage of the funds he received from investors in commodity futures trading accounts. He also admitted to incurring trading losses in the commodity futures trading accounts, and using the balance of funds he received from investors to pay other investors fictitious returns and to pay his personal expenses. Sharif admitted that he created and distributed to investors periodic statements falsely reflecting that they were earning returns on their investments. Sharif further admitted that the scheme he operated resulted in more than $3.6 million in losses to over 50 investors in Connecticut and other states.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Sharif 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 of trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71748 / March 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15804

In the Matter of **WILFRED J. HALPERN, CPA** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Wilfred J. Halpern, CPA ("Halpern" 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 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. These proceedings arise out of insider trading by Halpern, a personal tax accountant. Halpern purchased shares of SFN Group, Inc. ("SFN") on the basis of material nonpublic information that he learned when his long-time client, a company Insider (the "Insider"), called Halpern to seek tax advice in connection with an impending acquisition of SFN. The Insider specifically advised Halpern during the call that the information he shared was highly confidential and nonpublic. In violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 14(e) of the Exchange Act and Rule 14e-3 thereunder, Halpern misappropriated the information and breached his fiduciary duty to his client when, later that day, he purchased 9,500 shares of SFN. Halpern later tendered all of his shares for a profit of $41,023.

Respondent

2. **Halpern**, 88 years old, is a resident of Boynton Beach, Florida. Halpern is a practicing Certified Public Accountant ("CPA") licensed in New York and Florida. He is also licensed to practice law in New York State.

Other Relevant Entities

3. **SFN Group, Inc.** was a Delaware corporation headquartered in Fort Lauderdale, Florida. SFN's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange under the symbol "SFN." SFN was a strategic workforce solutions provider, offering temporary and permanent staffing solutions.

4. **Randstad Holding nv** ("RAND") is a Dutch multinational human resource consulting firm headquartered in the Netherlands. RAND is listed on the NYSE Euronext Amsterdam. On July 20, 2011, RAND announced that the company had entered into a definitive agreement to acquire SFN through a cash tender offer. The transaction closed on September 2, 2011.

Background

5. On May 9, 2011, RAND and SFN executives met, and RAND expressed an interest in pursuing an acquisition of SFN. By June 2011, RAND and SFN had entered into a confidentiality agreement and both companies had retained lawyers and investment bankers. On July 6, 2011, SFN's Board met to discuss the terms of the deal and agreed to make additional due diligence materials available to RAND and its advisors. On July 8, 2011, RAND's counsel provided SFN's counsel with an initial draft of a proposed merger agreement.

6. On July 12, 2011 at 10:03 a.m., Halpern received a call from his client, the Insider, seeking tax advice. At the time of the call, the Insider had material nonpublic information concerning an imminent tender offer by RAND for all of SFN's outstanding common stock. The Insider told Halpern that SFN was likely soon to be acquired and told Halpern the approximate per share price of the acquisition for purposes of calculating his potential gain.

7. During the call, the Insider told Halpern that the information regarding the possible acquisition was highly confidential and nonpublic.

8. Later that same afternoon of July 12, 2011, Halpern placed orders to purchase a total of 9,500 shares of SFN common stock at an average price of $9.60 per share in brokerage accounts that he and his wife owned or controlled.

9. By July 12, 2011, substantial steps had been taken in furtherance of the tender offer. Both SFN and RAND had signed confidentiality agreements, retained lawyers and investment bankers, and RAND had conducted extensive due diligence.

10. On July 20, 2011, approximately one week after Halpern purchased SFN stock, RAND announced that the company had entered into a definitive agreement to acquire SFN through a cash tender offer for $14.00 per share. After the announcement, SFN closed at $13.93, an increase in share price of $4.71, or 51% from the prior day's closing price and a total of approximately 25.8 million shares traded, compared with the previous day's volume of approximately 281,182 shares.

11. In connection with his trading, Halpern earned $41,023 in illicit trading profits.

12. Halpern knew that the information the Insider disclosed to him concerning the possible acquisition was material and non-public. By purchasing shares of SFN on the basis of that information, Halpern misappropriated the information and breached the duty that he owed to the Insider.

13. As a result of the conduct described above, Halpern willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibiting fraud in connection with the purchase or sale of securities, and Section 14(e) of the Exchange Act and Rule 14e-3 thereunder, prohibiting trading while in possession of material nonpublic information that was acquired directly or indirectly from someone working on behalf of the offeror or target of a tender offer.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Halpern cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 14(e) of the Exchange Act and Rule 14e-3 thereunder.

B. Respondent shall, within 15 days of the entry of this Order, pay disgorgement of $41,023, prejudgment interest of $2,637.94, and a civil penalty of $41,023 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) 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

(2) 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 Halpern 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 Andrew M. Calamari, Esq., Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 200 Vesey Street, Suite 400, New York, New York, 10281-1022.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 20, 2014

In the Matter of IVI Communications, Inc., Omnicity Corp., Precision Petroleum Corporation, PSB Group, Inc., Sustainable Power Corp., and Whitehall Jewelers Holdings, Inc. (n/k/a WJ Holdings Liquidating Company), 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 IVI Communications, Inc. 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 Omnicity Corp. 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 Precision Petroleum Corporation because it has not filed any periodic reports since the period ended June 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of PSB Group, 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 Sustainable Power Corp. because it has not filed any periodic reports since it registered its common stock under Exchange Act Section 12(g) pursuant to a Form 10-12G filed on February 12, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Whitehall Jewelers Holdings, Inc. (n/k/a WJ Holdings Liquidating Company) because it has not filed any periodic reports since the period ended February 2, 2008.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on March 20, 2014, through 11:59 p.m. EDT on April 2, 2014.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71753 / March 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15805

In the Matter of **IVI Communications, Inc.,** **Omnicity Corp.,** **Precision Petroleum Corporation,** **PSB Group, Inc.,** **Sustainable Power Corp., and** **Whitehall Jewelers Holdings, Inc.** **(n/k/a WJ Holdings Liquidating Company),** **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]

1. IVI Communications, Inc. ("IVII") (CIK No. 1140878) is a revoked Nevada corporation located in Milwaukee, Wisconsin with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IVII 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, 2008, which reported net income applicable to common shareholders of $168,569 for the prior nine months. As of March 13, 2014, the common stock of IVII was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC

[1]The short form of each issuer's name is also its stock symbol.

Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Omnicity Corp. ("OMCY") (CIK No. 1411586) is a revoked Nevada corporation located in Rushville, Indiana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). OMCY 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 $878,337 for the prior six months. As of March 13, 2014, the common stock of OMCY 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. Precision Petroleum Corporation ("PPTO") (CIK No. 1430057) is a Nevada corporation located in Newport Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PPTO 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 $241,547 for the prior nine months. As of March 13, 2014, the common stock of PPTO 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. PSB Group, Inc. ("PSBG") (CIK No. 1235091) is a dissolved Michigan corporation located in Madison Heights, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PSBG 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 $9,197,000 for the prior nine months. As of March 13, 2014, the common stock of PSBG 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. Sustainable Power Corp. ("SSTP") (CIK No. 1455674) is a revoked Nevada corporation located in Baytown, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SSTP is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it registered its securities on a Form 10-12G, filed on February 12, 2009, which reported a net loss of $5,565,434 for the nine months ended September 30, 2008. As of March 13, 2014, the common stock of SSTP 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. Whitehall Jewelers Holdings, Inc. (n/k/a WJ Holdings Liquidating Company) ("WHJH") (CIK No. 1368147) is a dissolved Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). WHJH 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 February 2, 2008, which reported a net loss of $74,117,000 for the prior year. On June 23, 2008, WHJH filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was dismissed on August 16, 2010. As of March 13, 2014, the common stock of WHJH 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

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

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71757 / March 20, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3800 / March 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15807

In the Matter of **FRANK MAZZOLA and** **FELIX INVESTMENTS, LLC** **Respondents.**	**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 Frank Mazzola ("Mazzola") and Felix Investments, LLC ("Felix Investments") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings and the findings contained in Section III.4 below, which are admitted, Respondents consent 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 Respondents' Offers, the Commission finds that:

Respondents and Other Relevant Party

1. Respondent Frank Mazzola, age 46, resides in Upper Saddle River, New Jersey, and since 2009 has been an owner of Respondent Felix Investments, a registered broker-dealer in New York City. During the relevant time period, Mazzola was a co-managing member of Facie Libre Management Associates, LLC. Mazzola holds Series 7, 8, 63, and 65 securities licenses.

2. During the relevant time period, Respondent Felix Investments was a registered broker-dealer in New York City, and was owned by Mazzola and three others. Felix Investments served as the exclusive placement agent for several funds created and managed by Mazzola and others. Felix Investments solicited investors for the private funds through its registered representatives, including Mazzola and others, provided the funds' offering materials to potential investors, and effected investors' purchases of interests in the funds.

3. Facie Libre Management Associates, LLC ("Facie Libre") is a Delaware limited liability company that served as the investment adviser to two pooled investment vehicles affiliated with Felix: Facie Libre Associates I, LLC and Facie Libre Associates II, LLC, (collectively, the "FLA Funds"), both of which engaged primarily in the business of investing in pre-IPO Facebook securities. During the relevant time period, Mazzola was a co-managing member of Facie Libre. As of January 2011, Facie Libre managed more than $41 million for hundreds of investors in the FLA Funds.

Final Judgment Imposing Permanent Injunctions

4. On March 10, 2014, a final judgment ("Final Judgment") was entered by consent, without admitting or denying any of the complaint's allegations, against Respondents in the civil action captioned Securities and Exchange Commission v. Frank Mazzola, et al., No. 12-CV-1258, in the United States District Court for the Northern District of California. The Final Judgment permanently enjoins Mazzola from violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder, and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder; and permanently enjoins Felix Investments from violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder.

5. The Commission's complaint alleged that Respondents engaged in a series of misrepresentations and deceptions to actual and prospective investors in the FLA Funds and other, similar pooled investment funds designed to invest in the securities of popular technology companies that had yet to go public. Specifically, the complaint alleged that for nearly a year Respondents failed to inform investors and prospective investors that Facebook had blocked the transfer of Facebook shares to the FLA Funds in several pending transactions. The complaint further alleged that Respondents failed to disclose that Felix had a written fee referral agreement with another broker-dealer and, as a result, Respondents misrepresented and failed to disclose the

full amount of compensation that Felix received as the exclusive placement agent for the FLA Funds. The complaint further alleged that Respondents solicited investors for the FLA Funds and for another fund created to invest in Twitter stock by making claims for which they had no reasonable basis. Finally, the complaint alleged that Respondents falsely led investors to believe that a fund created to invest in Zynga stock owned Zynga stock when it did not.

Undertakings

6. On or before August 31, 2014, Mazzola shall resign from, and have no further association with, Felix Investments and Felix Advisors, LLC (collectively, "Felix Entities").

7. During Respondent Mazzola's remaining association with Felix Investments and Felix Advisors, LLC, Mazzola shall not: (i) raise new capital; (ii) make capital calls from existing investors; or (iii) solicit any existing investors to roll their current investment into any other investment with the Felix Entities. Mazzola shall not receive any compensation, including any salary, bonus, or fees, for any services he provides during his remaining association with the Felix Entities.

8. Within thirty (30) days of the date of this Order, Mazzola shall cause the Felix Entities to engage, and to retain until such time as Mazzola has resigned from association with those entities, at the expense of the Felix Entities, an independent third-party consultant with compliance expertise (and who is not unacceptable to the Commission staff): (1) to review Mazzola's activities at the Felix Entities, including the scheduled resolution of certain funds; (2) to report to the Commission staff on an ongoing basis any violations or potential violations of this Order or the Final Judgment at either or both of the Felix Entities; and, upon the resignation of Mazzola (on or before August 31, 2014), to report to the Commission staff on the orderly departure of Mazzola from the Felix Entities. Mazzola shall cooperate fully with the independent third-party consultant thus engaged, including by providing that person with access to any and all documentation, files, data, and other materials requested for review to carry out the duties described in this Order.

9. Mazzola shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Mazzola agrees to provide such evidence. The certification and supporting material shall be submitted to Marshall Sprung, Co-Chief of the Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, CA 90036-3648, with a copy to the Office of Chief Counsel of the Division of Enforcement, 100 F Street, NE, Washington, DC 20549, no later than sixty (60) days from the date on which Mazzola ceases to be associated with the Felix Entities.

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, it is hereby ORDERED pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act that:

A. Respondent Mazzola is barred from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, 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; provided, however, that Respondent Mazzola may continue, until August 31, 2014, to remain associated with Felix Investments, LLC and Felix Advisors, LLC subject to the limitations set forth in the Undertakings and subject to the oversight of an independent third-party consultant retained for such purpose, in order to permit the orderly, scheduled resolution of certain funds. In the event Respondent Mazzola fails to comply with any of the Undertakings, he shall no longer be permitted to remain associated with Felix Investments, LLC or Felix Advisors, LLC but will instead be subject to the terms of the bar without any exceptions.

B. Any reapplication for association by Mazzola 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 Mazzola, 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.

C. Respondent Felix Investments is censured.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 20, 2014

In the Matter of **Network Dealer Services Holding Corp.,** **NextFit, Inc.,** **Rocky Mountain Minerals, Inc.,** **Titan Technologies, Inc.,** **Trudy Corporation,** **UAGH, Inc., and** **Uranium 308 Corp.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Network Dealer Services Holding Corp. because it has not filed any periodic reports since the period ended September 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of NextFit, 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 Rocky Mountain Minerals, Inc. because it has not filed any periodic reports since the period ended July 31, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Titan Technologies, Inc. because it has not filed any periodic reports since the period ended April 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Trudy Corporation because it has not filed any periodic reports since the period ended December 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of UAGH, Inc. because it has not filed any periodic reports since the period ended March 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Uranium 308 Corp. 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. EDT on March 20, 2014, through 11:59 p.m. EDT on April 2, 2014.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71755 / March 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15806

In the Matter of **Network Dealer Services Holding Corp.,** **NextFit, Inc.,** **Rocky Mountain Minerals, Inc.,** **Titan Technologies, Inc.,** **Trudy Corporation,** **UAGH, Inc., and** **Uranium 308 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 the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS[1]

1. Network Dealer Services Holding Corp. ("NTDR") (CIK No. 1278140) is a Utah corporation located in Clearfield, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NTDR 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, 2011, which reported a net loss of $421,730 for the prior nine months. As of March 13, 2014, the common stock of NTDR was quoted on OTC Link (formerly "Pink Sheets")

[1]The short form of each issuer's name is also its stock symbol.

operated by OTC Markets Group Inc. ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. NextFit, Inc. ("NXTZ") (CIK No. 1311344) is a defaulted Nevada corporation located in Sandy, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NXTZ 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 $9,442,187 for the prior nine months. As of March 13, 2014, the common stock of NXTZ 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. Rocky Mountain Minerals, Inc. ("RMMI") (CIK No. 312583) is a dissolved Wyoming corporation located in Prescott, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). RMMI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2009, which reported a net loss of $33,000 for the prior nine months. As of March 13, 2014, the common stock of RMMI 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. Titan Technologies, Inc. ("TITT") (CIK No. 932144) is a New Mexico corporation located in Albuquerque, New Mexico with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TITT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended April 30, 2010, which reported a net loss of $109,224 for the prior nine months. As of March 13, 2014, the common stock of TITT was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Trudy Corporation ("TRDY") (CIK No. 815098) is a Wyoming corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TRDY 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 $1,470,906 for the prior nine months. As of March 13, 2014, the common stock of TRDY 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. UAGH, Inc. ("UAGI") (CIK No. 1070699) is a delinquent Delaware corporation located in Woods Cross, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). UAGI 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, 2011, which reported a net loss of $79,087 for the prior nine months. As of March 13, 2014, the common stock of UAGI was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Uranium 308 Corp. ("URCO") (CIK No. 1349777) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). URCO 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 $228,985 for the prior nine months. As of March 13, 2014, the common stock of URCO was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3801 / March 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15808

In the Matter of

AARON JOUSAN JOHNSON,

Respondent.

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 Aaron Jousan Johnson ("Respondent" or "Johnson").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Johnson, age 33, is most recently a resident of Haddam, Connecticut.

2. From August 2009 to October 2013, Johnson was associated with J. Capital Advisors Wealth Management ("J. Capital"), an investment adviser registered with the state of Connecticut, and was its president and chief investment officer. From July 2001 to August 2009, Johnson was associated, successively, with three other entities that were dually registered with the Commission as broker-dealers and investment advisers, including VSR Financial Services Inc., from July 2007 to August 2009, A.G. Edwards & Sons Inc., from December 2003 to July 2007, and New England Securities, from July 2001 to December 2003.

B. ENTRY OF THE FINAL STATE ORDER

3. On October 21, 2013, the Connecticut Department of Banking (the "Department"), an agency that encompasses Connecticut's Securities and Business Investments Division, entered a final order entitled *In the Matter of J. Capital Advisors, LLC d/b/a J. Capital Advisors Wealth Management, and Aaron Jousan Johnson*, Docket No. RS-13-8063-S (the "Connecticut Order") against Johnson. The Connecticut Order found that Johnson violated, among others, provisions of Connecticut's securities laws that prohibit dishonest and unethical conduct. The Connecticut Order revoked Johnson investment adviser agent registration.

4. According to the Connecticut Order, Johnson failed to appear for his evidentiary hearing, so the following allegations against him were deemed admitted: Commencing in 2010, J. Capital had an arrangement with various clearing brokers pursuant to which J. Capital's advisory clients would authorize the clearing broker to pay J. Capital its fees as directed by J. Capital. From at least 2011 forward, the frequency and amount of fees deducted from J. Capital's client accounts at the participating clearing firms increased significantly, in some cases causing a marked depletion of client account holdings. Some of the affected clients filed complaints with the Department, indicating that they had not received prior disclosure concerning the extent of the fees or the basis on which the fees were calculated. In the course of the Department's examination of J. Capital, Johnson also submitted three client statements to the Department that contained falsified fee amounts and a falsified personal monthly statement. Finally, Johnson withdrew approximately $25,000 in fees from J. Capital's clients' accounts after his investment adviser agent registration was suspended by the Department on March 18, 2013.

5. The Connecticut Order constitutes a final order of a state securities commission (or agency or officer performing like functions) that imposes a bar from association with an entity regulated by such state securities commission or from engaging in the business of securities or insurance.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

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

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71761 / March 20, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3543 / March 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15659

In the Matter of THOMAS D. MELVIN, CPA	ORDER DENYING PETITION TO LIFT TEMPORARY SUSPENSION AND DIRECTING HEARING

On December 20, 2013, we issued an order instituting proceedings against Thomas D. Melvin pursuant to Commission Rule of Practice 102(e)(3)[1] that temporarily suspended him from appearing or practicing before the Commission based on his having been enjoined from violations of antifraud provisions of the securities laws.[2] Melvin petitions now that we lift that suspension.[3] As discussed below, we deny Melvin's request to lift the temporary suspension and set the matter down for a hearing before an administrative law judge.

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1 Rule of Practice 102(e)(3)(i), 17 C.F.R. § 201.102(e)(3)(i), provides, in 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, 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 . . . .

2 *Thomas D. Melvin*, Exchange Act Release No. 71161, 2013 WL 6705182 (Dec. 20, 2013).

3 Because it contains an explicit request to lift the temporary suspension, we deem the document styled "Entry of Appearance and Request for Hearing" a petition to lift the temporary suspension pursuant to Rule 102(e)(3)(ii).

The Order Instituting Proceedings in this matter alleges that Melvin is a certified public accountant and a partner in the accounting firm of Melvin, Rooks and Howell in Griffin, Georgia.[4] On August 14, 2013, the U.S. District Court for the Northern District of Georgia entered a final judgment against Melvin, permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.[5] The Commission's complaint, which forms the basis for the district court's injunction, alleges that Melvin and others were engaged in a fraudulent insider trading scheme. According to the complaint, Melvin misappropriated confidential information from one of his clients about an upcoming merger involving a company of which the client was director.[6] With this information, the complaint alleges, Melvin tipped four friends and business associates about the merger in violation of his fiduciary duties to his client, and the tippees then purchased shares of the target company and realized large profits.[7]

In instituting these disciplinary proceedings, we found it "appropriate and in the public interest" that Melvin 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 Melvin filed a petition challenging it within thirty days of service of the order, pursuant to Rule 102(e)(3)(ii). We further advised that, pursuant to Rule 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, Melvin requests that the temporary suspension be lifted, arguing that (i) the suspension order was "untimely under the Commission's Rules of Practice," and (ii) the Commission, "in conjunction with the negotiation of a settlement in corresponding civil enforcement proceedings," entered into a "binding agreement" with Melvin that he "would not be suspended in excess of the three years."

In its opposition to Melvin's petition, the Division of Enforcement contends that the December 20, 2013 suspension order was timely because it was issued within 90 days of the expiration of Melvin's time to appeal the district court's judgment.[8] The Division further

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4 *Melvin*, 2013 WL 6705182, at *1.

5 *SEC v. Thomas D. Melvin, Jr.*, No. 1:12-cv-2984 (N.D. Ga. Aug. 14, 2013).

6 Complaint for Injunctive Relief at 2-3, *SEC v. Thomas D. Melvin, Jr.*, No. 1:12-cv-2984 (N.D. Ga. Aug. 28, 2012), *available at* http://www.sec.gov/litigation/complaints/2012/comp22468.pdf.

7 *Id.* at 3.

8 Rule 102(e)(3), 17 C.F.R. § 201.102(e)(3), provides, "No order of temporary suspension shall be entered by the Commission . . . more than 90 days after the date on which the final judgment or order entered in a judicial or administrative proceeding became effective, whether upon completion of review or appeal or because further review or appeal procedures are no longer available."

contends that it made no such agreement with Melvin regarding the length of his suspension, and that such an agreement is inconsistent with the terms of the consent Melvin executed in conjunction with the settlement of the underlying case.

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 . . . any provision of the Federal securities laws or of the rules and regulations thereunder."[9] At this stage, it appears that the injunction issued against Melvin, based on alleged securities fraud violations, "justif[ies] the continuance of his suspension until it can be determined what, if any, action may be appropriate to protect the Commission's processes."[10] We therefore believe it is in the public interest to deny Melvin's request to lift the suspension.[11] We will set the matter down for a hearing before an administrative law judge, as provided in Rule 102(e)(3)(iii).[12] We express no opinion as to the merits of Melvin's claims.

Accordingly, IT IS ORDERED that the petition of Thomas D. Melvin to lift the temporary suspension entered on December 20, 2013, is denied and the suspension will remain in effect pending a hearing and decision in this matter; it is further

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; and 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.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

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[9] 17 C.F.R. § 201.102(e)(3)(i)(a).

[10] *Williams D. Shovers*, Exchange Act Release No. 59874, 2009 WL 1271170, at *2 (May 6, 2009).

[11] *Cf. Virginia K. Sourlis*, Exchange Act Release No. 69358, 2013 WL 1453371, at *2 (Apr. 10, 2013) (denying request by an attorney to lift a Rule 102(e)(3) temporary suspension because "[c]ontinuing [petitioner's] temporary suspension pending a hearing on the issues raised in [the] petition serves the public interest and protects the Commission's processes"); *Stewart A. Merkin*, Exchange Act Release No. 68981, 2013 WL 661621, at * 2 (Feb. 25, 2013) (same).

[12] 17 C.F.R. § 201.102(e)(3)(iii).

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71766 / March 21, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3802 / March 21, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15809

In the Matter of **PATRICK J. SULLIVAN,** **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 Patrick J. Sullivan ("Sullivan" 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, 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. Sullivan was the co-founder and a member of Winchester Financial Securities, LLC ("Winchester"), an insurance sales entity and unregistered investment adviser. From July 1999 through July 2007, and from October 2007 through July 2009, Sullivan was also a registered representative associated with broker-dealers registered with the Commission. Sullivan, 44 years old is a resident of Cumberland Rhode Island.

2. On September 14, 2011, Sullivan pled guilty to four counts of interstate transportation of property taken by fraud in violation of Title 18 United States Code, Section 2314 before the United States District Court for the District of Rhode Island, in United States v. Patrick Sullivan, Case Information No.. 1:11CR00141-01ML. On April 23, 2012, a judgment in the criminal case was entered against Sullivan. He was sentenced to a prison term of 21 months followed by three years of supervised release and ordered to make restitution in the amount of $424,905.00.

3. The counts of the criminal information to which Sullivan pled guilty alleged, inter alia, that between 2005 and 2010, Sullivan defrauded investors by soliciting client funds for investment and then converting the funds for his own personal use.

4. In connection with that plea, Respondent admitted that:

   a.) Beginning in or about January 2005, Sullivan assisted four clients of Winchester Financial Services to withdraw funds from the annuity accounts that each of these clients held at Metropolitan Life Insurance Company ("MetLife");
   b.) Sullivan completed MetLife withdrawal forms for each of these clients and forwarded the forms to MetLife. MetLife then prepared withdrawal checks in the amounts requested on the forms and provided the checks to Sullivan's four clients;
   c.) After receiving the checks, Sullivan persuaded the clients to invest a portion of the funds with Winchester;
   d.) On numerous occasions beginning in January 2005 and continuing through May 2010, the four clients each provided Sullivan with checks payable to Winchester and directed Sullivan to invest the funds on their behalf;
   e.) To obtain the checks, Sullivan traveled from Rhode Island to Massachusetts where each of the four clients resided;

f.) After obtaining the checks, Sullivan returned to Rhode Island and deposited the checks in Winchester's general account at Citizens Bank; and

g.) After depositing the checks, Sullivan did not invest the funds on behalf of the four clients, but instead used the funds to pay his personal and business expenses.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Sullivan'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 Sullivan be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Ch. II

[Release Nos. 33-9563, 34-71771, IA-3803, IC-30989, File No. S7-04-14]

Regulatory Flexibility Agenda

AGENCY: Securities and Exchange Commission.

ACTION: Notice of semiannual regulatory agenda.

SUMMARY: The Securities and Exchange Commission approved the publication of an agenda of its rulemaking actions pursuant to the Regulatory Flexibility Act. The agenda, which is not a part of or attached to this document, was submitted by the Commission to the Regulatory Information Service Center for inclusion in the Unified Agenda of Federal Regulatory and Deregulatory Actions, which is scheduled for publication in its entirety on www.reginfo.gov in spring 2014. The version of the Unified Agenda to be published in the Federal Register will include only those rules for which the agency has indicated that preparation of an analysis under the Regulatory Flexibility Act is required. Information in the Commission's agenda was accurate on March 21, 2014, the date on which the Commission's staff completed compilation of the data. To the extent possible, rulemaking actions by the Commission after that date will be reflected in the agenda. The Commission invites questions and public comment on the agenda and on the individual agenda entries.

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

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

Electronic comments:

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

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-04-14 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-04-14. 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: Anne Sullivan, Office of the General Counsel, 202-551-5019.

SUPPLEMENTARY INFORMATION: The Regulatory Flexibility Act ("RFA"), (Pub. L. No. 96-354, 94 Stat. 1164 (September 19, 1980), requires each federal agency in April and October of each year to publish in the Federal Register an agenda identifying rules that the agency expects to consider in the next twelve months that are likely to have a significant economic impact on a substantial number of small entities (5 U.S.C. 602(a)). The RFA specifically provides that publication of the agenda does not preclude an agency from considering or acting on any matter not included in the agenda, and that an agency is not required to consider or act on any matter that is included in the agenda (5 U.S.C. 602(d)). The Commission may consider or act on any matter earlier or later than the estimated date provided on the agenda. While the agenda reflects the current intent to complete a number of rulemakings in the next year, the precise dates for each rulemaking at this point are uncertain. Actions that do not have an estimated date are placed in the long term category; the Commission may nevertheless act on items in that category within the next twelve months. The agenda includes new entries, entries carried over from previous publications, and rulemaking actions that have been completed (or withdrawn) since publication of the last agenda. The Commission invites public comment on the agenda and on the individual agenda entries.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Dated: March 21, 2014

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71768 / March 21, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15810

In the Matter of **The Phoenix Companies, Inc. and PHL Variable Insurance Company** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against The Phoenix Companies, Inc. ("Phoenix") and PHL Variable Insurance Company ("PHL Variable," collectively with Phoenix, "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 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Respondents

1. The Phoenix Companies, Inc. ("Phoenix") is a Delaware corporation located in Hartford, Connecticut with equity securities and bonds registered with the Commission pursuant to Section 12(b) of the Exchange Act. Phoenix is a holding company with three insurance company subsidiaries, Phoenix Life Insurance Company ("PLIC"), Phoenix Life and Annuity Company, and PHL Variable, which sell life insurance and annuity products. Phoenix is delinquent in its periodic filings with the Commission, having not filed a periodic report since it filed a Form 10-Q for the period ended June 30, 2012. Phoenix common stock trades on the New York Stock Exchange (symbol "PNX") and Phoenix bonds trade on the New York Stock Exchange (symbol "PFX"). Phoenix qualifies as an "accelerated filer" as defined in Rule 12b-2 of the Exchange Act.

2. PHL Variable Insurance Company ("PHL Variable") is a Connecticut corporation located in Hartford, Connecticut and is a wholly owned indirect subsidiary of Phoenix. PHL Variable's stock does not trade on an exchange. PHL Variable is delinquent in its periodic filings with the Commission, having not filed a periodic report since it filed a Form 10-Q for the period ended June 30, 2012. PHL Variable qualifies as a "non-accelerated filer" as defined in Rule 12b-2 of the Exchange Act.

Facts

3. On September 18, 2012, PHL Variable announced that its previously issued audited financial statements for the years ended December 31, 2011, 2010 and 2009 could no longer be relied upon and should be restated, along with the unaudited financial statements for the quarterly periods dating back to March 31, 2011. PHL Variable disclosed that certain errors were identified "primarily related to the accounting for an intercompany reinsurance treaty" between PHL Variable and PLIC, and that these errors concerned "ceded premiums, and certain periodic adjustments to receivables, deferred acquisition costs and liability for policyholder benefits."

4. In turn, on November 8, 2012, Phoenix announced that its previously issued audited financial statements for the years ended December 31, 2011, 2010, and 2009 could no longer be relied upon and should be restated, along with the unaudited financial statements for quarterly periods dating back to March 31, 2011. Phoenix listed two principal error categories, including the incorrect classification of deposits and withdrawals of universal life and variable universal life products and the incorrect reporting of certain fees and interest charges as cash flows provided by financing activities. Phoenix also warned that "[m]anagement will likely conclude that there are one or more material weaknesses" in its disclosure controls and

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

procedures and internal controls over financial reporting. Phoenix stated that it expected to file restated financial statements prior to the timely filing of its 2012 Annual Report on Form10-K in March 2013.

5. On March 15, 2013, Phoenix announced that it would not meet its previously announced timetable for filing the restatement and its Quarterly Report on Form 10-Q for the period ended September 30, 2012 and that it would not timely file its 2012 Annual Report on Form 10-K. Phoenix also disclosed the discovery of additional errors affecting prior periods including actuarial valuation of certain insurance liabilities and deferred policy acquisition cost assets, accounting for complex reinsurance transactions, and valuation of certain private debt securities and derivative instruments. Finally, Phoenix also disclosed that it "expects that it will continue to identify, assess for materiality and correct additional errors during the course of the Restatement, some of which may be material and adverse."

6. On April 24, 2013, Phoenix announced that it was making "significant progress" on the restatement, but declined to set a new target filing deadline. Instead, Phoenix indicated that it would "provide further updates on timing and estimated financial impact on or before May 31, 2013." Phoenix predicted that it "may not be able to timely file its Quarterly Reports on Form 10-Q for the first, second and third quarters of 2013"—a prediction that proved accurate. Phoenix also warned that its ability to complete the restatement would be "subject to a number of contingencies, including but not limited to, whether Phoenix continues to identify errors in its consolidated financial statements, [and] whether existing systems and processes can be timely updated, supplemented or replaced."

7. Phoenix made additional restatement-related announcements on May 31, 2013, but it did not provide a sense of the progress made or the expected completion date. On June 28, 2013, Phoenix announced in a news release that, "restatement work continues to move forward" and that Phoenix "intends to provide another update on the restatement within the next 60 days." In addition, Phoenix announced that it did not expect to file "2012 audited statutory financial statements of its insurance company subsidiaries with the insurance regulators in the states in which its insurance company subsidiaries are authorized to conduct business within the timeframes afforded by current extensions granted by their respective domiciliary states," because they are "dependent on substantial completion of the GAAP restatement process." Moreover, Phoenix announced that, "the situation remains fluid as additional issues are identified and resolved."

8. On August 15, 2013, Phoenix announced in a news release that, "restatement work continues to move forward" and that Phoenix "intends to provide an update on the restatement within the next 60 days." On October 15, 2013, Phoenix announced, "[w]e believe we are in the final phases of the restatement work, and we are preparing our corrective and delayed filings. Once the filing timetable is established, we expect to provide a further update on the restatement." As of December 30, 2013, no specific timetable was disclosed to investors. On January 17, 2014, Phoenix announced that it expects to file its 2012 Form 10-K with the Commission by March 31, 2014 and become a timely filer with the filing of its second quarter 2014 Form 10-Q.

9. Phoenix's securities, including common stock and bonds listed on the New York Stock Exchange, have continued to trade in the absence of recent audited financial data. As of December 30, 2013, Phoenix common stock traded on the New York Stock Exchange with an average daily trading volume of 36,908 over the prior three months and Phoenix bonds traded on the New York Stock Exchange with an average daily trading volume of 11,622 over the prior three months. On November 8, 2012, the closing stock price was $25.31, but since that time the stock price has increased, closing at $59.62 as of December 30, 2013.

Legal Analysis

10. Section 13(a) of the Exchange Act requires issuers with classes of securities registered pursuant to Section 12 of the Exchange Act to file periodic and other reports with the Commission. With exceptions not applicable here, Rules 13a-1 and 13a-13 of the Exchange Act require each such issuer to file annual and quarterly reports respectively on the appropriate forms and within the period specified on the form. Phoenix is subject to the filing requirements of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

11. Section 15(d) of the Exchange Act requires issuers not registered pursuant to Section 12 of the Exchange Act, but with a registration statement which has become effective pursuant to the Securities Act of 1933, to file periodic and other reports with the Commission. Rules 15d-1 and 15d-13 of the Exchange Act require each such issuer to file annual and quarterly reports respectively on the appropriate forms and within the period specified on the form. PHL Variable is subject to the filing requirements of Section 15(d) of the Exchange Act and Rules 15d-1 and 15d-13 thereunder.

12. Form 10-Q requires that accelerated filers such as Phoenix submit their quarterly reports within 40 days after the end of the fiscal quarter and that non-accelerated filers such as PHL Variable submit their quarterly reports within 45 days after the end of the fiscal quarter. Forms 10-K must be filed by accelerated filers such as Phoenix within 75 days after the end of the fiscal year and within 90 days after the end of the fiscal year for non-accelerated filers such as PHL Variable.

13. Since PHL Variable's September 18, 2012 restatement announcement and Phoenix's November 8, 2012 restatement announcement, Respondents have failed to file any quarterly or annual reports as required by Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder and Section 15(d) of the Exchange Act and Rules 15d-1 and 15d-13 thereunder, and each has missed five separate filing deadlines as of December 31, 2013, four pertaining to quarterly reports and one pertaining to an annual report, which are catalogued on the following charts:

Phoenix Chart of Delinquent Filings (as of March 19, 2014)		
Form	**Period**	**Deadline**
10-Q	Quarter ended September 30, 2012	November 9, 2012

Phoenix Chart of Delinquent Filings (as of March 19, 2014)		
Form	**Period**	**Deadline**
10-K	Year ended December 31, 2012	March 18, 2013
10-Q	Quarter ended March 31, 2013	May 10, 2013
10-Q	Quarter ended June 30, 2013	August 9, 2013
10-Q	Quarter ended September 30, 2013	November 12, 2013
10-K	Year ended December 31, 2013	March 17, 2014

PHL Variable Chart of Delinquent Filings (as of March 19, 2014)		
Form	**Period**	**Deadline**
10-Q	Quarter ended September 30, 2012	November 14, 2012
10-K	Year ended December 31, 2012	April 1, 2013
10-Q	Quarter ended March 31, 2013	May 15, 2013
10-Q	Quarter ended June 30, 2013	August 14, 2013
10-Q	Quarter ended September 30, 2013	November 14, 2013

Violations

14. As a result of the conduct described above, Respondent Phoenix violated Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and annual and quarterly reports within the period specified in the appropriate form.

15. As a result of the conduct described above, Respondent PHL Variable violated Section 15(d) of the Exchange Act and Rules 15d-1 and 15d-13 thereunder, which require issuers not registered pursuant to Section 12 of the Exchange Act, but with a registration statement which has become effective pursuant to the Securities Act of 1933, to file with the Commission information, documents, and annual and quarterly reports within the period specified in the appropriate form.

Undertakings

Respondent Phoenix has undertaken to:

16. By no later than March 31, 2014, file its Form 10-K for the fiscal year ended December 31, 2012.

17. By no later than April 15, 2014, file its Form 10-Q for the quarterly period ended September 30, 2012.

18. By no later than June 4, 2014, file its Form 10-K for the fiscal year ended December 31, 2013.

19. By no later than July 15, 2014, file its Form 10-Q for the quarterly period ended March 31, 2013.

20. By no later than July 15, 2014, file its Form 10-Q for the quarterly period ended March 31, 2014.

21. By no later than August 11, 2014, file its Form 10-Q for the quarterly period ended June 30, 2013.

22. By no later than November 10, 2014, file its Form 10-Q for the quarterly period ended September 30, 2013.

Respondent PHL Variable has undertaken to:

23. By no later than April 15, 2014, file its Form 10-K for the fiscal year ended December 31, 2012.

24. By no later than April 30, 2014, file its Form 10-Q for the quarterly period ended September 30, 2012.

25. By no later than July 3, 2014, file its Form 10-K for the fiscal year ended December 31, 2013.

26. By no later than August 4, 2014, file its Form 10-Q for the quarterly period ended March 31, 2013.

27. By no later than August 4, 2014, file its Form 10-Q for the quarterly period ended March 31, 2014.

28. By no later than September 8, 2014, file its Form 10-Q for the quarterly period ended June 30, 2013.

29. By no later than September 8, 2014, file its Form 10-Q for the quarterly period ended June 30, 2014.

30. By no later than November 14, 2014, file its Form 10-Q for the quarterly period ended September 30, 2013.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Phoenix cease and desist from committing or causing any violations and any future violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

B. Pursuant to Section 21C of the Exchange Act, Respondent PHL Variable cease and desist from committing or causing any violations and any future violations of Section 15(d) of the Exchange Act and Rules 15d-1 and 15d-13 thereunder.

C. Respondent Phoenix shall comply with the undertakings in Section III paragraphs 16 through 22 above; provided, however, that solely for the purpose of complying with those undertakings, Phoenix shall not be deemed to have violated Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

D. Respondent PHL Variable shall comply with the undertakings in Section III paragraphs 23 through 30 above; provided, however, that solely for the purpose of complying with those undertakings, PHL Variable shall not be deemed to have violated Section 15(d) of the Exchange Act and Rules 15d-1 and 15d-13 thereunder.

E. Respondent Phoenix shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $375,000 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 make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(2) 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 Phoenix 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 Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

F. Respondent PHL Variable shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $375,000 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 make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(2) 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 PHL Variable 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 Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71770 / March 21, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3544 / March 21, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-12105

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

On November 18, 2005, Brendon P. McDonald, CPA ("McDonald") was suspended from appearing or practicing before the Commission as an accountant as a result of settled public administrative proceedings instituted by the Commission against McDonald pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1] This order is issued in response to McDonald's application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

In a civil action entitled Securities and Exchange Commission v. Fred Gold, et al., a final judgment was entered against McDonald permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and from aiding and abetting violations of Section 15(d) of the Exchange Act and Rules 12b-20 and 15d-1 thereunder. The Commission's complaint alleged that American Tissue, Inc. ("American Tissue") materially overstated its assets, shareholders' equity, revenue and net income in periodic reports filed with the Commission during 2000 and 2001 by capitalizing previously recorded expenses as inventory and overvaluing finished goods inventory. The complaint further alleged that Arthur Andersen LLP ("Andersen") issued an unqualified audit report on American Tissue's financial statements for its fiscal year ended September 30, 2000

[1] *See* Accounting and Auditing Enforcement Release No. 2346 dated November 18, 2005. McDonald was permitted, pursuant to the order, to apply for reinstatement after five years upon making certain showings.

though its audit was not conducted in accordance with generally accepted auditing standards and American Tissue's financial statements were not fairly presented in conformity with generally accepted accounting principles. According to the complaint, McDonald, an experienced senior at Andersen, was one of the auditors responsible for the audit failure. In addition, the Complaint alleged that, subsequent to the completion of the audit, McDonald altered audit workpapers in preparation for a peer review by another audit firm and he instructed members of the audit engagement team to gather all American Tissue related documents for shredding, other than the "official" work paper file.

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

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

On the basis of information supplied, representations made, and undertakings agreed to by McDonald, it appears that he has complied with the terms of the November 18, 2005 order suspending him from appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that McDonald, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

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

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

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

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9564 / March 25, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15812

In the Matter of the Registration Statement of Creative Vision Alliance Corporation, 210 White Wing Dr. #B Columbia, South Carolina 29229 Respondent.	ORDER FIXING TIME AND PLACE OF PUBLIC HEARING AND INSTITUTING PROCEEDINGS PURSUANT TO SECTION 8(d) OF THE SECURITIES ACT OF 1933

I.

The Commission's public official files disclose that:

On March 12, 2014, Creative Vision Alliance Corporation, ("Respondent") filed a Form S-1 registration statement (the "Registration Statement") with the Commission. Respondent's Registration Statement was labeled as a "prospectus" and states that Respondent plans to issue 7,000,000 shares of common stock at an offering price of $.25 per share.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent is a South Carolina corporation headquartered in Columbia, South Carolina.

B. MATERIAL DEFICIENCIES

1. The Registration Statement does not include audited financial statements, as required by Form S-1, Part 1—Information Required in Prospectus, Item 11(e), and Regulation S-X of the Securities Act of 1933 ("Securities Act"). *See* Form S-1, Part 1—Information Required in Prospectus, Item 11(e).

2. The Registration Statement fails to provide management's discussion and analysis of Creative Vision's historical and interim financial information as required by Form S-1, Part 1---Information Required in Prospectus, Item 11(h), and Regulation S-K, Item 303. *See* Form S-1, Part 1—Information Required in Prospectus, Item 11(h).

3. The Registration Statement fails to provide signatures as required by Form S-1, Part II. *See* Form S-1.

III.

The Commission, having considered the aforesaid, deems it appropriate and in the public interest that public proceedings pursuant to Section 8(d) of the Securities Act be instituted with respect to the Registration Statement to determine whether the allegations of the Division of Enforcement are true; to afford the Respondent an opportunity to establish any defenses to these allegations; and to determine whether a stop order should issue suspending the effectiveness of the Registration Statement referred to herein.

Accordingly, IT IS ORDERED that public proceedings be and hereby are instituted under Section 8(d) of the Securities Act, such hearing to be commenced at 2:00 p.m. on April 7, 2014, at the Commission's offices at 100 F Street N.E., Washington, DC 20549, and to continue thereafter at such time and place as the hearing officer may determine.

IT IS FURTHER ORDERED that these proceedings shall be presided over by an Administrative Law Judge to be designated by further order, who is authorized to perform all the duties of an Administrative Law Judge as set forth in the Commission's Rules of Practice or as otherwise provided by law.

IT IS 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, pursuant to Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220. If the 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 the 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. This Order shall be served forthwith upon the Respondent in accordance with 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 120 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71803 / March 26, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15813

In the Matter of **China Shen Zhou Mining & Resources, Inc., Ideal Financial Solutions, Inc., Smooth Global (China) Holdings, Inc., Weikang Bio-Technology Group Co., Inc., and 1st Pacific Bancorp,** **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 China Shen Zhou Mining & Resources, Inc., Ideal Financial Solutions, Inc., Smooth Global (China) Holdings, Inc., Weikang Bio-Technology Group Co., Inc., and 1st Pacific Bancorp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. China Shen Zhou Mining & Resources, Inc. (CIK No. 790024) is a Nevada corporation located in Beijing, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Shen Zhou Mining 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, 2012, which reported a net loss of over $8 million for the prior nine months. As of March 19, 2014, the company's stock (symbol "CSHZ") 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. Ideal Financial Solutions, Inc. (CIK No. 1302849) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ideal Financial 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, 2011. As of March 19, 2014, the company's stock (symbol "IFSL") was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Smooth Global (China) Holdings, Inc. (CIK No. 1077637) is a Nevada corporation located in Beijing, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Smooth Global is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended June 30, 2011. As of March 19, 2014, the company's stock (symbol "SMGH") 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. Weikang Bio-Technology Group Co., Inc. (CIK No. 1365354) is a Nevada corporation located in Harbin, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Weikang 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. As of March 19, 2014, the company's stock (symbol "WKBT") was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. 1st Pacific Bancorp (CIK No. 1380712) is a suspended California corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 1st Pacific 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, 2009, which reported a net loss of over $17.1 million for the prior nine months. As of March 19, 2014, the company's stock (symbol "FPBN") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

6. As 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/or 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 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, 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 26, 2014

In the Matter of **China Shen Zhou Mining & Resources, Inc.,** **Ideal Financial Solutions, Inc.,** **Smooth Global (China) Holdings, Inc.,** **Weikang Bio-Technology Group Co., Inc., and** **1st Pacific Bancorp** **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 Shen Zhou Mining & Resources, Inc. because it has not filed any periodic reports since the period ended September 30, 2012.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ideal Financial Solutions, Inc. because it has not filed any periodic reports since the period ended September 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Smooth Global (China) Holdings, Inc. because it has not filed any periodic reports since the period ended June 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Weikang Bio-Technology Group Co., 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 1st Pacific Bancorp because it has not filed any periodic reports since the period ended September 30, 2009.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on March 26, 2014, through 11:59 p.m. EDT on April 8, 2014.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9565 / March 27, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 71823 / March 27, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3545 / March 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15815

In the Matter of

L&L ENERGY, INC.
and DICKSON LEE, CPA

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE 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") and Sections 4C and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e) of the Commission's Rules of Practice against Dickson Lee, and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act and Section 21C against L&L Energy, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

This action arises out of a fraudulent scheme by L&L Energy and Dickson Lee to create the appearance that L&L was run by a professional management team and conceal Lee's single-handed control of the company. L&L Energy is a Seattle-headquartered coal company with all of its operations in China and Taiwan. At all relevant times, it was led by Dickson Lee, its current Chairman of the Board and Chief Executive Officer. From approximately August 2008 to June 2009, L&L and Lee repeatedly and fraudulently misrepresented to the public that it had certain persons serving in critical executive management roles at the company when, in reality, those persons served in no such roles.

First, in its Form 10-K for the fiscal year 2008, L&L falsely represented that Lee's brother served as the company's CEO when, in reality, Lee served in that role and ran the day to day operations of the company. In that same filing, L&L represented that a former company employee ("the purported Acting CFO") had served as the company's Acting Chief Financial Officer when, in reality, the purported Acting CFO had emailed Lee a month prior to the 2008 Form 10-K and rejected the Acting CFO position. In the company's next three quarterly report filings for 2009, L&L and Lee continued to misrepresent that the purported Acting CFO was in fact the company's Acting CFO. For example, L&L's public filings contained certifications required under the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley) that ostensibly bore the purported Acting CFO's electronic signature when, in reality, the purported Acting CFO had not signed any L&L public filings during this period; did not provide authorization for her signature to be placed on any L&L public filings; and did not perform any of the reviews necessary to have a basis for any of the attestations contained on the Sarbanes-Oxley certifications.

In approximately May 2009, the purported Acting CFO learned that L&L had been falsely representing her as the company's Acting CFO and confronted Lee and the chair of L&L's Audit Committee. In response, Lee separately admitted to the purported Acting CFO and the Audit Committee Chair that the purported Acting CFO had not performed the duties of L&L's Acting CFO, and then directed the Audit Committee Chair to conceal this fact from both the company's Board and the public. Lee maintained his fraudulent scheme by continuing to falsely represent to L&L's Board of Directors that the purported Acting CFO had served as the Acting CFO. Lastly, during the fall of 2009, in connection with an application for L&L to gain listing on NASDAQ, Lee misled NASDAQ by informing it that the company had made all of the required Sarbanes-Oxley certifications – including during the period of the purported Acting CFO's ostensible service. As a result, L&L became listed on the NASDAQ.

RESPONDENTS

1. **L&L** is a Seattle, Washington headquartered coal company with all of its operations in China and Taiwan. The company became public through a reverse merger in August 2001. L&L's common stock is registered with the Commission pursuant to Exchange Act Section 12(b), and its stock is currently listed on NASDAQ.

2. **Dickson Lee**, age 65, is the company's founder and has been L&L's Chairman of the Board and Chief Executive Officer since August 2008. Lee previously served as CEO from 1995 through July 2007 and Chairman at various periods. He previously held CPA licenses in Washington and New York (both licenses have lapsed, with the Washington license lapsing in June 2012) and previously audited public companies. Lee obtained his Series 7 license in 1998 and his Series 24 and 27 licenses in 2000. Lee was an associated person with a number of broker dealers until about 2005.

FACTS

A. The Purported Acting CFO Rejects Acting CFO Position

3. In August 2007, L&L publicly announced that Lee had resigned his position as L&L's Chairman of the Board and CEO. Lee resigned those positions shortly after he was disciplined by the National Association of Securities Dealers, Inc. ("NASD") and received a one-year suspension for conducting private placement offerings of L&L securities in which the private placement memoranda contained false statements. Lee believed that, if he was an L&L officer, his suspension would impede L&L from becoming listed on a stock exchange.

4. At that time, Lee installed his brother as the CEO of L&L (hereinafter "Lee's brother"). During the one-year period (August 2007 – August 2008) in which Lee's brother held the title of L&L's CEO, however, Lee continued to run the company as he had when he held the title of CEO.

5. In January 2008, L&L's stock became quoted on the Over-The-Counter Bulletin Board ("OTCBB"). In order to gain listing on a larger trading venue, such as NASDAQ, Lee sought to hire a Chief Financial Officer ("CFO").

6. L&L hired a CFO in February 2008, but within two months that person resigned. As L&L sought a replacement CFO, Lee proposed the name of a former employee and L&L director (hereinafter, "the purported Acting CFO") as a candidate for L&L's Acting CFO position.

7. In approximately June 2008, Lee, on L&L's behalf, engaged a U.S.-based placement agent (the "placement agent") to assist L&L in raising money from investors. This placement agent encouraged L&L to hire a CFO. In a June 18, 2008 email, Lee referred to the purported Acting CFO as a member of the management team that had been requested by the placement agent. In another June 2008 email, Lee wrote that the purported Acting CFO could become L&L's Acting CFO in order to meet the placement agent's "requirement."

8. On June 23, 2008, members of L&L's board and Lee held a meeting. At that meeting, Lee communicated that the purported Acting CFO would be appointed as the company's Acting CFO because the placement agent "suggested that L&L needs to have [an] Acting CFO (a Non-Officer position) as one of the conditions to move L&L's funding forward."

9. On that same day, at Lee's instruction, Lee's assistant sent the purported Acting CFO an email thanking her for becoming L&L's Acting CFO. The purported Acting CFO, however, had never accepted the Acting CFO position.

10. On July 14, 2008, the purported Acting CFO forwarded to Lee the June 23, 2008 email she received from his assistant regarding the Acting CFO position and informed Lee that she was "unable to become L&L Acting CFO as I don't have time to make any contribution to L&L. I need to take care of my own job and my kids as well . . . I wish you could find a more suitable CFO soon."

B. L&L Falsely Represents Lee's Brother and the Purported Acting CFO as the Company's CEO and Acting CFO

11. On August 12, 2008, L&L filed its Form 10-K with the Commission for its fiscal year ended April 30, 2008 (the "2008 Form 10-K"). Lee reviewed the filing before it was made public.

12. L&L, in its 2008 Form 10-K, falsely represented that Lee's brother had performed the functions of the company's CEO when, in reality, Lee continued to perform the functions of the company's CEO.

13. Moreover, in that same filing, L&L reported for the first time that the purported Acting CFO had been named as the company's Acting CFO, disclosing that "she is a CPA with experience of both U.S. and China accounting practices. She was a senior auditing manager for a New York CPA firm with PCAOB qualification, and conducted US GAAP audits for US public listed companies." These representations were false because the purported Acting CFO had rejected the Acting CFO position.

14. L&L's 2008 Form 10-K contained certifications required under Sarbanes-Oxley for the company's principal executive officer and principal financial officer, namely, its CEO and CFO. These certifications contained the electronic signatures of both Lee's brother and the purported Acting CFO by which each of them attested to, among other things, the fact that the 2008 Form 10-K contained no untrue statements of material fact.

15. Neither Lee's brother nor the purported Acting CFO, however, provided any such attestation and neither Lee's brother nor the purported Acting CFO provided any authorization to have their electronic signatures placed on their respective Sarbanes-Oxley certifications.

16. L&L, in its 2008 Form 10-K, also falsely represented that it had – with the participation of its CEO (Lee's brother) and CFO (the purported Acting CFO) – evaluated the effectiveness of the design and operation of its disclosure controls and procedures, and based on such evaluation, the company, its CEO (Lee's brother), and CFO (the purported Acting CFO) concluded that the disclosure controls and procedures were effective.

C. L&L and Lee Continue their Scheme to Falsely Represent the Purported Acting CFO as the Acting CFO

17. On August 25, 2008, after his one-year NASD suspension was over, Lee officially returned to the position of L&L's CEO and Chairman of the Board.

18. On September 15, 2008, L&L filed with the Commission its Form 10-Q for the period ended July 31, 2009 (the "First Quarter 2009 Form 10-Q"). Lee signed the filing. Like the 2008 Form 10-K, the First Quarter 2009 Form 10-Q contained a Sarbanes-Oxley certification that was ostensibly electronically signed by the purported Acting CFO. Moreover, the First Quarter 2009 Form 10-K also contained the representation that the CEO (Lee) and the purported Acting CFO had evaluated the effectiveness of the design and operation of the company's disclosure controls and procedures and those controls and procedures were effective.

19. The purported Acting CFO, however, did not serve as the company's Acting CFO in any capacity; did not authorize her electronic signature to be placed on the Sarbanes-Oxley certifications; did not perform any of the reviews or functions enumerated on the Sarbanes-Oxley certifications; and did not evaluate the effectiveness of the company's disclosure controls and procedures.

20. The First Quarter 2009 Form 10-Q also contained a Sarbanes-Oxley certification for Lee. In his Sarbanes-Oxley certification, Lee falsely certified that, to his knowledge, L&L's First Quarter 2009 Form 10-Q contained no untrue statements of material fact.

21. In approximately December 2008, L&L retained a U.S.-based investment research firm to write a research report concerning L&L. In late December 2008, the research firm emailed Lee a draft research report for his review. The research report contained a prominent section on L&L's management team, listed the purported Acting CFO as the company's CFO and stated that the purported Acting CFO "coordinates all accounting for L&L." Lee sent a revised version of the research report to the research firm with some "minor changes," but did not correct the false statements regarding the purported Acting CFO. This report was published in approximately April 2009 and included the false statements regarding the role of the purported Acting CFO.

22. On December 22, 2008, L&L filed with the Commission its Form 10-Q for the period ended October 31, 2008, and on March 23, 2009, L&L filed with the Commission its Form 10-Q for the period ended January 31, 2009. Lee signed both of these filings. These two public filings again contained false, electronically signed, Sarbanes-Oxley certifications by the purported Acting CFO. Moreover, these two filings contained the false statements concerning the purported Acting CFO's evaluation of the effectiveness of the company's disclosure controls and procedures.

23. These two public filings also contained Lee's own Sarbanes-Oxley certification in which he again falsely certified that, to his knowledge, the Form 10-Qs contained no untrue statements of material fact.

24. As noted above, L&L placed electronic signatures on the public filings to reflect that the purported Acting CFO had signed the requisite Sarbanes-Oxley certifications. The Commission staff requested from L&L, but never received, the actual signature pages bearing the purported Acting CFO's signature for each of the requisite Sarbanes-Oxley certifications.

25. On August 12, 2009, L&L filed its 2009 Form 10-K, which contained Lee's Sarbanes-Oxley certification that, based on his and the CFO's most recent evaluation of the company's internal control over financial reporting, all fraud involving management had been disclosed to the company's auditors and to the company's Audit Committee. This certification was false because Lee had not disclosed to the company's external auditors or the company's entire Audit Committee that the purported Acting CFO was misrepresented in L&L's previous filings as its Acting CFO.

D. Lee Admits to Purported Acting CFO that She Did Not Perform the Work of the Acting CFO

26. In approximately May 2009, the purported Acting CFO became aware that L&L had falsely represented her as the company's Acting CFO in the company's public filings and, on May 6, 2009, sent Lee an email that included her July 14, 2008 email in which she rejected the Acting CFO position. In the email, the purported Acting CFO wrote that she "clearly indicated that [she] would not accept the offer of being the Acting CFO of L&L," and asked Lee for an immediate explanation.

27. On May 13, 2009, Lee emailed the purported Acting CFO and wrote, "[t]here is a misunderstanding of the Acting CFO role . . . Based on your input, your name is removed to please you." The purported Acting CFO replied that – just because she and Lee had known each other for ten years – it did not mean "that you could use my name, without authorisation, to the file 10K to the U.S. SEC." In response, on May 19, 2009, Lee emailed the purported Acting CFO and separately admitted, "[y]ou did not actually conduct the work as Acting [CFO]."

E. Lee Admits to L&L's Audit Committee Chair That Purported Acting CFO Did Not Serve as Acting CFO

28. On May 21, 2009, the purported Acting CFO emailed Shirley Kiang, who was then the Chair of L&L's Audit Committee and member of its Board of Directors. In the email, the purported Acting CFO told Kiang that she had a "serious and urgent" matter related to L&L's public information made without her knowledge and asked Kiang to investigate.

29. Kiang subsequently contacted Lee and asked whether the purported Acting CFO had actually served as the company's Acting CFO. Lee initially informed Kiang that the purported Acting CFO had served as the company's Acting CFO and was making false allegations in an attempt to obtain money from the company.

30. Kiang asked Lee for evidence to support his assertion that the purported Acting CFO had served as the company's Acting CFO. In response, Lee provided Kiang with a letter that

appeared to be addressed to the purported Acting CFO, dated May 28, 2008, and purported to be signed by Lee's brother as the company's CEO. The letter asked the purported Acting CFO to confirm that she had agreed to accept the Acting CFO position and stated that if the company did not receive a response to the letter within ten days, the company would treat her lack of response as her acceptance of the position.

31. This letter, however, was not created on May 28, 2008; was not signed by Lee's brother; and was never sent to the purported Acting CFO. Rather, this letter was created on May 26, 2009 – almost one year after the purported Acting CFO had rejected the Acting CFO position – and was stored in Lee's L&L computer network folder.

32. On June 4, 2009 – after receiving no response from Kiang – the purported Acting CFO emailed Kiang again. The purported Acting CFO again asked Kiang to investigate her allegations, specifically that she was misrepresented in L&L's filings as the company's Acting CFO, and included her July 14, 2008 email to Dickson Lee rejecting the Acting CFO position.

33. After receiving the June 4 email, Kiang again asked Dickson Lee for an explanation. Lee then admitted to Kiang that the purported Acting CFO had not actually served as the company's Acting CFO and that he had used the purported Acting CFO's name on L&L's public filings without the purported Acting CFO's permission. Lee directed Kiang to not disclose this information to anyone, including the company's Board of Directors or the public, and told her that if this information became publicly known, L&L's stock price would drop.

34. After this, Lee continued to falsely represent to the company's Board of Directors that the purported Acting CFO had served as the company's Acting CFO.

35. During the nearly one-year period in which the purported Acting CFO was falsely represented as the company's Acting CFO, L&L raised approximately $750,000 from investors using stock purchase agreements in which L&L expressly attested to the accuracy of its public filings and private placement documents that referred the investor to publicly available additional information about the company.

F. L&L Makes Materially False and Misleading Statements on NASDAQ Application to Gain NASDAQ Listing

36. In approximately September 2009, L&L completed an application to become listed on the NASDAQ. As part of the application process, NASDAQ requested a variety of information, including confirmation that the company had made all of the required Sarbanes-Oxley certifications.

37. L&L, in a communication from Lee, confirmed that the company had made all of the required Sarbanes-Oxley certifications. L&L misled NASDAQ in this communication because it did not inform NASDAQ that its required CFO Sarbanes-Oxley certifications for its 2008 Form 10-K or its three 2009 Form 10-Qs were false. As a result, L&L gained listing on NASDAQ in February 2010.

VIOLATIONS

38. By engaging in the conduct described above, L&L violated – and Lee willfully violated – Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibits fraudulent conduct in connection with the purchase or sale of securities. Also, by engaging in the conduct described above, Lee willfully aided and abetted and caused L&L's violations of Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder.

39. By engaging in the conduct described above, L&L violated – and Lee willfully violated – Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

40. By engaging in the conduct described above, L&L violated – and Lee willfully aided and abetted and caused violations of – Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, which require issuers of registered securities to file factually accurate annual and quarterly reports. Also, L&L violated – and Lee willfully aided and abetted and caused violations of – Rule 12b-20 of the Exchange Act, which requires the addition to such reports of further material information necessary to make the required report statements not misleading.

41. By engaging in the conduct described above, L&L violated – and Lee willfully violated, and willfully aided and abetted and caused violations of – Rule 13a-14 of the Exchange Act, which requires, among other things, that principal executive and financial officers certify that based on their knowledge, the issuer's financial statements are accurate, and that, based on the principal executive and financial officer's most recent evaluation of the company's internal control over financial reporting, they have disclosed all fraud, whether or not material, involving management to the company's auditors and Audit Committee.

42. By engaging in the conduct described above, L&L violated – and Lee willfully aided and abetted and caused violations of – Rule 13a-15 of the Exchange Act, which requires each issuer's management, with the participation of the company's principal executive officer and principal accounting officer, or persons performing similar functions, to evaluate the effectiveness of the company's disclosure controls and procedures on a quarterly basis.

43. By engaging in the conduct described above, L&L violated – and Lee willfully aided and abetted and caused violations of – Section 302 of Regulation S-T of the Exchange Act, which requires that (i) a signatory to an electronic filing actually sign the signature page before or at the time of the electronic filing; (ii) the filer retain the original executed document for five years; and (iii) that the filer provide the Commission staff with a copy of the document upon request.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and in the public interest that public administrative and cease-and-desist proceedings against Lee, and public cease-and-desist proceedings against L&L, 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 L&L, including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act and Section 8A of the Securities Act;

C. What, if any, remedial action is appropriate in the public interest against Lee, including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act and Section 8A of the Securities Act;

D. What, if any, remedial action is appropriate in the public interest against Lee, including, but not limited to, a permanent officer and director bar pursuant to Section 21C(f) of the Exchange Act and Section 20(e) of the Securities Act;

E. What, if any, remedial action is appropriate in the public interest against Lee, including, but not limited to, being permanently denied the privilege of appearing or practicing before the Commission pursuant to Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice;

F. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, L&L should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, Exchange Act Rules 13a-14 and 13a-15, and Section 302(b) of Regulation S-T of the Exchange Act; and

G. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Lee should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, Exchange Act Rules 13a-14, and 13a-15, and Section 302(b) of Regulation S-T of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that L&L and Lee shall file Answers 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, the 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.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71824 / March 27, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3546 / March 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15816

In the Matter of **SHIRLEY KIANG** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Shirley Kiang ("Respondent").

II.

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

III.

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

Summary

From August 2008 to approximately June 2009, L&L Energy, Inc. (L&L), a Seattle-headquartered coal company with all of its operations in China – led by its Chairman of the Board and Chief Executive Officer, Dickson Lee – misrepresented in public filings with the Commission that a person served as the company's Acting Chief Financial Officer when, in reality, she never did (hereinafter, the "purported Acting CFO"). In May 2009, the purported Acting CFO became aware that L&L had falsely represented her as the company's actual Acting CFO and asked Shirley Kiang, who was then the company's Audit Committee Chair and a Director, to investigate. Kiang approached Lee regarding the purported Acting CFO's allegations, and he told Kiang that the purported Acting CFO had never served as the company's actual Acting CFO and to not share this information with anyone, including the company's Board of Directors and the public. In August 2009, L&L filed its Form 10-K for the 2009 fiscal year, and it included a false certification required under the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") that – based on Lee's and the other certifying officer's most recent evaluation of the company's internal control over financial reporting – any fraud, whether or not material, involving management had been disclosed to the company's auditors and the company's Audit Committee. Kiang signed this public filing as a Director and Audit Committee Chair when she knew or should have known that the filing contained this false Sarbanes-Oxley certification.

Respondent

1. **Shirley Kiang,** age 63, was associated with L&L from 1998 to August 2012 as a board member. Kiang was also a member of L&L's Audit Committee from its inception in July 2008 through August 2012, and was the Audit Committee Chair from approximately July 2008 through at least the filing of L&L's 2009 Form 10-K on August 13, 2009. Kiang is a U.S. citizen, currently living in Thailand.

Facts

2. Beginning in approximately April 2008, L&L did not have a CFO, as its prior CFO had just resigned. L&L, led by Lee, wanted to hire an Acting CFO and, to that end, thought of the purported Acting CFO, who had previously been associated with the company as an accountant from 1997 to 2004, and as a director until 2006.

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

3. In a July 14, 2008 email to Lee, the purported Acting CFO rejected an offer to become L&L's Acting CFO.

4. Notwithstanding this rejection, L&L falsely represented that the purported Acting CFO was the company's actual Acting CFO in four separate public filings with the Commission, including the company's Form 10-K for fiscal year 2008, and three subsequent Form 10-Qs for fiscal year 2009. Each filing included a Sarbanes-Oxley certification with the purported Acting CFO's digital signature that she had, among other things, attested to the accuracy of the company's financial statements and the appropriateness of the company's disclosure controls and procedures. The purported Acting CFO, however, never performed any such functions.

5. In May 2009, the purported Acting CFO became aware that L&L had falsely represented her as the company's actual Acting CFO in the above-described filings and sent various emails to Lee, demanding an explanation. In a May 19, 2009 email, Lee wrote to the purported Acting CFO that she "did not perform the work of the Acting CFO."

6. On May 21, 2009, the purported Acting CFO emailed Kiang, who was then the Chair of the company's three person Audit Committee and member of the company's Board of Directors. Prior to this email, Kiang had no interaction with the purported Acting CFO with regard to any L&L business. In the email, the purported Acting CFO told Kiang that she had a "serious and urgent" matter related to L&L's filings that were made without her knowledge and asked her to investigate.

7. Kiang subsequently contacted Lee and asked whether the purported Acting CFO had actually served as the company's Acting CFO, and was informed that the purported Acting CFO had actually served as the company's Acting CFO and was making false allegations in an attempt to obtain money from the company. Kiang contacted no one else, including anyone at the company or the company's external auditors, to investigate whether the purported Acting CFO had actually served as the company's Acting CFO.

8. On June 4, 2009 – after receiving no response from Kiang – the purported Acting CFO emailed her again. The purported Acting CFO asked whether Kiang had investigated the allegations that she had not actually served as the company's Acting CFO, and in the email, included her July 14, 2008 email in which she rejected the offer to be L&L's Acting CFO.

9. After receiving the email, Kiang asked Lee for an explanation. Lee told Kiang that the purported Acting CFO had not actually served as the company's Acting CFO; that he had used the purported Acting CFO's name on L&L's public filings without the purported Acting CFO's permission; told Kiang not to worry about it because it was in the past[2]; told Kiang to not tell anyone about the purported Acting CFO, including the company's Board of Directors or the public; and that, if she shared this information with anyone, L&L's reputation would be affected negatively and its stock price would drop.

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[2] On June 23, 2009, L&L issued a Form 8-K in which it announced that it had hired a California resident as the company's Acting CFO. The California resident, unlike the purported Acting CFO, actually did perform the duties of a CFO.

10. On August 12, 2009, L&L filed its 2009 Form 10-K, which contained a false Sarbanes-Oxley certification that – based on Lee's and the other certifying officer's most recent evaluation of the company's internal control over financial reporting – any fraud, whether or not material, involving management had been disclosed to the company's auditors and to the company's Audit Committee. Kiang signed L&L's 2009 Form 10-K as Audit Committee Chair and a Director, when she knew or should have known that any fraud, whether or not material, involving management had not been disclosed to the company's auditors and the company's Audit Committee.

Violation

11. Under Section 21C of the Exchange Act, the Commission may impose a cease-and-desist order upon, among others, any person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation of any provision of the Exchange Act.

12. Section 13(a) of the Exchange Act requires issuers that have securities registered pursuant to Section 12 of the Exchange Act to file such periodic and other reports as the Commission may prescribe and in conformity with such rules as the Commission may promulgate. Exchange Act Rule 13a-1 requires the filing of annual reports. In addition to the information expressly required to be included in such reports, Rule 12b-20 under the Exchange Act requires issuers to add such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. "The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports." *SEC v. Savoy Industries*, 587 F.2d 1149, 1165 (D.C. Cir. 1978) (citing *SEC v. IMC Int'l, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex. 1974)). A violation of the reporting provisions is established if a report is shown to contain materially false or misleading information. *SEC v. Kalvex, Inc.*, 425 F. Supp. 310, 316 (S.D.N.Y. 1975).

13. L&L violated Exchange Act Section 13(a) and Rules 12b-20 and 13a-1 thereunder by filing an annual report – the 2009 Form 10-K – that included a false Sarbanes-Oxley certification that – based on the CEO's and the other certifying officer's most recent evaluation of the company's internal control over financial reporting – any fraud, whether or not material, involving management had been disclosed to the company's auditors and the company's Audit Committee.

14. By engaging in the conduct described above, Kiang caused L&L's violations of Exchange Act Section 13(a) and Rules 12b-20 and 13a-1 thereunder.

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 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Kiang cease and desist from committing or causing any violations and any future violations of Exchange Act Section 13(a) and Rules 12b-20 and 13a-1 promulgated thereunder.

B. To effect compliance with the above-referenced provision and rules of the Exchange Act, Kiang permanently refrain from signing any Commission public filing that contains any certification required pursuant to the Sarbanes-Oxley Act of 2002.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3805 / March 27, 2014

INVESTMENT COMPANY ACT OF 1940
Rel. No. 30997 / March 27, 2014

Admin. Proc. File No. 3-14194

In the Matter of

MICHAEL R. PELOSI

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Fraud

Associated person of registered investment adviser charged with providing false and misleading portfolio performance returns in quarterly and annual letters to his clients. *Held*, the proceeding is *dismissed* because the record does not support finding of liability.

APPEARANCES:

John R. Hewitt of Gibbons P.C., for Michael R. Pelosi.

Richard M. Harper II and *John J. Kaleba*, for the Division of Enforcement.

Appeal filed: January 27, 2012
Last brief received: August 16, 2013

I.

Michael R. Pelosi, a former portfolio manager, vice president, and part-owner of Halsey Associates, Inc. ("Halsey"), a registered investment adviser, appeals from a decision of an administrative law judge finding that Pelosi violated the antifraud provisions of the Investment Advisers Act of 1940 by overstating his clients' portfolio performance returns in quarterly and annual letters between 2005 and 2008.[1] The law judge barred Pelosi from associating with an investment company or investment adviser, fined him $60,000, and ordered him to cease and desist from committing or causing further violations of the Advisers Act's antifraud provisions.

II.

This case concerns representations Pelosi made to his clients in client letters discussing the performance of their investment accounts that Pelosi managed.[2] From February 2005 to August 2008, consistent with Halsey's practice, Pelosi routinely prepared and mailed letters to his clients discussing the clients' portfolio performance for the previous period. Neither Halsey nor Pelosi informed the clients, either in such letters or by other disclosure, how their performance results were calculated.

Halsey gave its portfolio managers monthly performance reports generated from the firm's computer system (the "Halsey Reports"), with the expectation that the portfolio managers would quote the rates of return in the Halsey Reports when they drafted their client letters. In August 2008, Halsey's two principals discovered that, in many instances, the returns that Pelosi had been reporting in his client letters differed from those reflected in the Halsey Reports. The principals subsequently confronted Pelosi, who initially denied changing the firm's performance figures but the next day admitted that he used his own figures. Soon thereafter, Halsey terminated Pelosi's association with the firm. But pursuant to an agreement with Pelosi, Halsey filed a Form U5 that failed to disclose the circumstances that led to the termination as required by the form.[3]

Ten months later, prompted by questions from Halsey's largest client, the firm filed an amended Form U5 disclosing that Pelosi had been previously fired for "inaccurately reporting performance results to his clients in written communications." An ensuing Commission

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1 *Michael R. Pelosi*, Initial Decision Rel. No. 448, 2012 WL 681582 (Jan. 5, 2012).

2 Performance is generally expressed as a percentage and measures the return realized in a portfolio by the investment manager over a specified time period.

3 Form U5, the Uniform Termination Notice for Securities Industry Registration, requires disclosure of the nature of the termination when it is not voluntary.

investigation culminated in the institution of this proceeding against Pelosi alleging that he violated Advisers Act Sections 206(1) and (2).[4]

III.

At the administrative hearing, the Division entered into evidence 243 of Pelosi's client letters and reports for the periods covered in these letters that were recreated by Halsey from its computer system (the "Recreated Halsey Reports") in response to a 2011 production request from the Division.[5] The Division asserted that a side-by-side comparison of the letters with the Recreated Halsey Reports showed that Pelosi violated the antifraud provisions by falsely inflating his clients' portfolio performance and that he acted with scienter because his returns were materially higher than the Recreated Halsey Reports' returns in a number of instances.

On appeal, Pelosi argues that all the Division has proved in this case is that his reported performance numbers did not match the numbers in the Recreated Halsey Reports, not that his performance calculations were improper. He asserts that he used alternative methods to calculate performance and that he was justified in reporting these calculations to clients because he believed that his figures, not the firm's computer-generated performance figures, more accurately reflected his clients' account performance.

IV.

Based on our *de novo* review of the record, we have determined to dismiss the proceedings based on the Division's failure to meet its burden of proof. The Division's case rests on the premise that Pelosi's returns were false because they materially differed from the Recreated Halsey Reports, which the Division holds out as reflecting the clients' actual performance results. But the Division did not establish either that the Recreated Halsey Reports accurately reflected the reports Pelosi saw at the time of the alleged misconduct or that the Recreated Halsey Reports accurately reflected the clients' returns.

The only record information concerning the accuracy of the Recreated Halsey Reports in either respect is testimony from Halsey staff, primarily the portfolio assistants and one of Halsey's principals. In the initial decision, the law judge concludes that Halsey's "pricing and reconciliation" were "for the most part" "accurate," stating that the Halsey employees, "all of whom were credible witnesses, testified to that accuracy."[6] The Commission gives "considerable

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4 15 U.S.C. § 80b-6(1)-(2) (prohibiting investment advisers from "defraud[ing] any client or prospective client" or "engag[ing] in any . . . practice . . . which operates as a fraud or deceit").

5 Halsey was required to do so because it had not kept hard copies of the Halsey Reports actually given to Pelosi during the period at issue.

6 *Pelosi*, 2012 WL 681582, at *12.

weight to the credibility determination of a law judge since it is based on hearing the witnesses' testimony and observing their demeanor. Such determinations can be overcome only where the record contains substantial evidence for doing so."[7]

Here, the record does not provide substantial evidence to overcome the law judge's finding that the Halsey witnesses were credible. But their testimony, however credible, did not substantiate the accuracy of the Recreated Halsey Reports. Rather, the Halsey witnesses testified only generally as to the method that they would follow, and the type of information that was entered into Axys, in a typical pricing and reconciliation process at the time of the alleged misconduct. That method included the downloading of data from the custodians, manual entry of various pricing data, and one principal's manual pricing of certain bond assets, but the record includes no records showing this data. The witnesses did not provide any specific information about the method used or the data that was entered into Axys to produce the Recreated Halsey Reports adduced at the hearing. Thus, the law judge did not have a sufficient basis on which to conclude, based only on the Halsey witnesses' testimony, that the Recreated Halsey Reports either accurately reflected the Halsey Reports seen by Pelosi at the time of the alleged misconduct or accurately reflected the clients' account performance.[8] We find no basis in the record to support either conclusion.

The Division could have introduced expert testimony, or other authoritative evidence, to establish the performance of the accounts at issue. Calculation of performance of a client's individual portfolio necessarily depends on client-specific variables, such as the individual portfolio's cash flows, asset allocation, and client comparison preferences. The investment management industry has developed several different methodologies that may be used to calculate rates of return for existing clients based on their individual circumstances. While these different methodologies may yield different results, any of them, properly used, might yield results that would be considered acceptable or at least not materially false. Because of the variables affecting the calculation of an individual client's account performance, and the diverse methods deemed acceptable for factoring these variables into performance calculation, proper determination of the clients' portfolio performance is complex and would likely yield a number of potentially accurate calculations for any given client account. The Division's evidence neither established such calculations nor provided any other basis for determining the clients' actual performance results. For these reasons, we believe that the record lacks an evidentiary basis from

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7 *E.g., Robert M. Fuller*, Securities Exchange Act Rel. No. 48406, 56 SEC 976, 2003 WL 22016309, at *7 (Aug. 25, 2003) (internal quotation marks and citation omitted), *petition denied*, 95 F. App'x 361 (D.C. Cir. 2004).

8 *Cf. Kevin Hall, CPA*, Exchange Act Rel. No. 61162, 2009 WL 4809215, at *9 (Dec. 14, 2009) (distinguishing between an ALJ's appropriate use of witness credibility to find, as fact, that auditors had reviewed certain documentation and the ALJ's inappropriate use of credibility to then conclude, as a matter of law, that such review was reasonable and consistent with GAAS).

which to determine that the returns reported by Pelosi to his clients were materially false or misleading.

Under the circumstances and based on our de novo review, we have determined to dismiss the proceeding against Pelosi because the Division failed to establish his liability by a preponderance of evidence. But we note that many aspects of this case, including practices at the firm as evidenced by the record, raise troubling questions. We emphasize that our decision is based solely on the application of the theory the Division charged and litigated to the facts developed in this record. Because there is insufficient evidence establishing that the representations at issue were materially false or misleading, we do not address the other elements of the alleged fraud.[9]

An appropriate order will issue.

By the Commission (Chair WHITE and Commissioners STEIN and PIWOWAR; Commissioners AGUILAR and GALLAGHER not participating).

Lynn M. Powalski
Deputy Secretary

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9 We deny as moot Pelosi's request to adduce additional evidence and did not consider such evidence in resolving this matter. *See, e.g.*, *Theodore W. Urban,* Order Dismissing Proceedings, Exchange Act Rel. No. 66259, 2012 WL 1024025, at *1 n.5 (Jan. 29, 2012) (denying requests for oral argument and to adduce additional evidence as moot "'given the [Commission's] resolution of th[e] matter'" in such party's favor (quoting *D.E. Wine Invs., Inc.*, Exchange Act Rel. No. 43929, 54 SEC 1213, 2001 WL 98581, at *4 n.25 (Feb. 6, 2001))).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3805 / March 27, 2014

INVESTMENT COMPANY ACT OF 1940
Rel. No. 30997 / March 27, 2014

Admin. Proc. File No. 3-14194

In the Matter of MICHAEL R. PELOSI

ORDER DISMISSING PROCEEDING

On the basis of the Commission's opinion issued this day, it is ORDERED that this proceeding is hereby dismissed.

By the Commission.

Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71816 / March 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15814

In the Matter of **Hendrx Corp.,** **Plastinum Polymer Technologies Corp.,** **Vertical Branding, Inc.,** **WHY USA Financial Group, Inc., and** **XNE, 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]

1. Hendrx Corp. ("HDRX") (CIK No. 1082696) is a revoked Nevada corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HDRX is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $1,547,524 for the prior nine months. As of March 25, 2014, the common stock of HDRX was quoted on OTC Link operated by OTC Markets Group, Inc. (formerly ("Pink Sheets) ("OTC Link"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

[1]The short form of each issuer's name is also its stock symbol.

2. Plastinum Polymer Technologies Corp. ("PLNU") (CIK No. 1368044) is a void Delaware corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PLNU 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 $7,916,613 for the prior nine months. As of March 25, 2014, the common stock of PLNU 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. Vertical Branding, Inc. ("VBDG") (CIK No. 1125532) is a void Delaware corporation located in Sun Valley, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). VBDG 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 $2,061,000 for the prior nine months. On April 23, 2010, VBDG filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Central District of California, which was dismissed on January 21, 2011. As of March 25, 2014, the common stock of VBDG 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. WHY USA Financial Group, Inc. ("WUFG") (CIK No. 1113450) is a Nevada corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). WUFG 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, 2009, which reported a net loss of $830,402 for the prior six months. As of March 25, 2014, the common stock of WUFG 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. XNE, Inc. ("XNEZ") (CIK No. 1069778) is a revoked Nevada corporation located in Woodland Hills, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). XNEZ 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 $632,181 for the prior nine months. As of March 25, 2014, the common stock of XNEZ was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 27, 2014

In the Matter of **Hendrx Corp.,** **Plastinum Polymer Technologies Corp.,** **Vertical Branding, Inc.,** **WHY USA Financial Group, Inc., and** **XNE, 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 Hendrx Corp. because it has not filed any periodic reports since the period ended September 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Plastinum Polymer Technologies 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 Vertical Branding, 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 WHY USA Financial Group, Inc. because it has not filed any periodic reports since the period ended June 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of XNE, Inc. because it has not filed any periodic reports since the period ended September 30, 2008.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on March 27, 2014, through 11:59 p.m. EDT on April 9, 2014.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 229, 230, 232, 239, 240, 243, and 249

Release Nos. 33-9568; 34-71830; File No. S7-08-10

RIN 3235-AK37

Extension of Comment Period for Asset-Backed Securities Release

AGENCY: Securities and Exchange Commission

ACTION: Extension of comment period.

SUMMARY: On February 25, 2014, the Securities and Exchange Commission re-opened the comment period on two releases related to asset-backed securities. The Commission re-opened the comment period to permit interested persons to comment on an approach for the dissemination of potentially sensitive asset-level data. The comment period is scheduled to end on March 28, 2014. In light of public interest in providing comment on the approach, the Commission is extending the comment period until April 28, 2014 to permit interested persons additional time to analyze and comment on the approach.

DATES: Comments should be received on or before April 28, 2014.

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-08-10 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

which is described in a staff memorandum, dated February 25, 2014, that has been previously included in the public comment file.[4]

The comment period is scheduled to end on March 28, 2014. We have received requests for an extension of time for public comment.[5] The Commission believes that providing the public additional time to consider and comment on the matters outlined in the staff memorandum and submit comprehensive responses would benefit the Commission in its consideration of the final rules. Therefore, we are extending the comment period until April 28, 2014.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Date: March 28, 2014

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4 See Memorandum from the Commission's Division of Corporation Finance (dated Feb. 25, 2014), which is available on the Commission's Internet Web site at http://www.sec.gov/comments/s7-08-10/s70810.shtml.

5 See letters from Ally Financial Inc. dated Mar. 14, 2014, Bank of America Corporation dated Mar. 18, 2014, CNH Industrial Capital America LLC dated Mar. 20, 2014, Ford Motor Credit Company LLC dated Mar. 10, 2014, Mortgage Bankers Association dated Mar. 14, 2014, Structured Finance Industry Group dated Mar. 10, 2014, Volvo Financial Services dated Mar. 25, 2014 and World Omni Financial Corp. dated Mar. 24, 2014. The public comments we received are available at http://www.sec.gov/comments/s7-08-10/s70810.shtml.