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 **June 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

(78 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 21, 2014

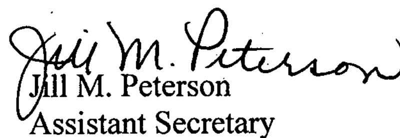
In The Matter Of	:	
	:	
Citadel EFT, Inc.	:	**ORDER OF SUSPENSION OF TRADING**
	:	
File No. 500-1	:	

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Citadel EFT, Inc. ("Citadel") because of questions regarding the accuracy of assertions by Citadel in public statements regarding the company's business operations and assets. In particular, there are questions regarding the accuracy, completeness, and validity of Citadel's several recent press releases, Form 8-Ks, and other public statements since January 2014 relating to transactions involving standby letters of credit ("SBLC's"), *see Prime Bank Instrument Fraud*, TreasuryDirect.gov (U.S. Department of the Treasury), http://www.treasurydirect.gov/instit/statreg/fraud/fraud_primebank.htm (last visited Mar. 20, 2014) and Brazilian Letras Tesouro Nacional ("LTN's"), *see Frauds Related to Public Bonds*, Tesouro Nacional (Brazil), https://www.tesouro.fazenda.gov.br/en/about-the-federal-public-debt/frauds-related-to-public-bonds (last visited Mar. 20, 2014). Citadel is a Wyoming corporation based in Oceanside, California. It is quoted on OTC Link under the symbol CDFT.

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 21, 2014 through 11:59 p.m. EDT, on April 3, 2014.

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. 72287 / June 2, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15897

In the Matter of Cloudeeva, Inc., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

1. Respondent Cloudeeva (CIK No. 932818) is a Florida corporation located in San Ramon, California as reflected in information on file with the Florida Secretary of State. It has a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). As of April 22, 2014, Cloudeeva's common stock (symbol "SYAI") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group Inc., had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. The most recent reporting period with respect to which the company has filed a periodic report is the quarter ended June 30, 2006, for which it filed a Form 10QSB on August 21, 2006.

3. On September 23, 2011, the Division of Corporation Finance sent a delinquency letter to Respondent.

4. Respondent failed to heed the delinquency letter sent to it by the Division of Corporation Finance or, through its failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letter.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondent registered pursuant to Section 12 of the Exchange Act, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
June 2, 2014

In the Matter of **Cloudeeva, 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 Cloudeeva, Inc. because Cloudeeva, Inc. has not filed any periodic reports for any reporting period subsequent to June 30, 2006.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed 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, June 2, 2014, through 11:59 p.m. EDT, on June 13, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31066 / June 2, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15898

In the Matter of **Christopher B. Ruffle,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Christopher B. Ruffle ("Ruffle" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

4 of 78

III.

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

Summary

This case involves a prohibited joint transaction orchestrated by the UK-based Martin Currie group of institutional investment managers. In April 2009, in the midst of the financial crisis, Martin Currie used its U.S.-registered investment company client, The China Fund, Inc. (the "China Fund"), to invest in a convertible bond transaction which directly benefited another Martin Currie client, a hedge fund called the Martin Currie China Hedge Fund L.P. (the "Hedge Fund"). The Hedge Fund, an affiliated person of the China Fund, had previously acquired significant, and largely illiquid, exposure (in the form of bonds) to a single Chinese company and required liquidity to satisfy mounting redemption requests from its investors.

Ruffle, a portfolio manager and head of Martin Currie's China operations, negotiated the convertible bond transaction and, together with others at Martin Currie, caused the China Fund to invest in convertible bonds issued by a subsidiary of this Chinese company. The Chinese company used 44% of the investment proceeds to redeem a substantial portion of the preexisting bonds held by the Hedge Fund, thereby alleviating the Hedge Fund's liquidity concerns.

The convertible bond transaction turned out to be a poor investment for the China Fund. In November 2010, the board of the China Fund wrote down the value of the unlisted convertible bonds to zero. In April 2011, the China Fund eventually sold the convertible bonds for 55% of their face value.

By structuring a convertible bond investment by the China Fund which directly benefited the Hedge Fund without a Commission order, Ruffle willfully aided and abetted and caused a violation of the joint transaction provision of the Investment Company Act.

Respondent

Christopher B. Ruffle ("Ruffle"), 55, was formerly the lead portfolio manager for the China Fund, the Hedge Fund, and other clients of Martin Currie. Ruffle joined Martin Currie in 1994 as a member of the emerging markets team and, starting in 2002, headed the firm's China operations in Shanghai. Effective July 2011, Ruffle ceased performing portfolio management functions for clients of Martin Currie and is no longer associated with Martin Currie. Ruffle, who resides in Shanghai, is currently the co-owner of Open Door Capital Advisors (US), LLC, a registered investment adviser with its office in San Francisco.

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

Other Relevant Entities

1. **Martin Currie Ltd.** ("Martin Currie") is a company organized under the laws of Scotland and headquartered in Edinburgh, Scotland. Martin Currie wholly owns Martin Currie Inc. ("MCI") and Martin Currie Investment Management Ltd. ("MCIM"), investment advisers registered with the Commission. MCIM and MCI operate from the same offices and share common employees. MCI served as adviser to the China Fund and during the relevant period, managed approximately $6.3 billion in assets. MCIM served as adviser to the Hedge Fund and during the relevant period, managed approximately $11.4 billion in assets.

2. **The China Fund, Inc.** ("China Fund") is a corporation organized under the laws of Maryland and is a closed-end investment company registered with the Commission. The China Fund's shares are listed on the NYSE under the symbol CHN. MCI was the investment manager to the China Fund's portfolio of listed and unlisted securities during the relevant time period.

3. **Martin Currie China Hedge Fund L.P.** ("Hedge Fund") was a limited partnership organized under the laws of Bermuda and was a private fund managed by MCIM. U.S. investors invested in the Hedge Fund through, among other things, a U.S. private feeder fund known as MC Absolute Return China Fund LLC, a Delaware limited liability company.

4. **Jackin International Holdings** ("Jackin") is a company organized under the laws of Bermuda and located in Hong Kong, China. Jackin's stock is listed on the Hong Kong Stock Exchange ("HKSE") under the code 630. Jackin changed its name to Guojin Resources Holdings Ltd. in November 2010 and now operates under the name AMCO Ltd. Jackin conducts its printer cartridge recycling business through a chain of wholly-owned subsidiaries including Ugent Holdings Ltd. ("Ugent") and Afex International (HK) Ltd. ("Afex").

Facts

A. Ruffle's Role as Head of Martin Currie's China Operations

5. The China Fund, Hedge Fund, and other clients of Martin Currie made similar investments in China under the direction of Ruffle, who, starting in 2002, headed the firm's China operations from Shanghai. Ruffle was later joined by PM-2, another portfolio manager who assisted Ruffle in managing the firm's Chinese investments.

6. In 2006, in order to retain Ruffle's services at the firm, Martin Currie entered into a joint venture with Heartland Capital Management Ltd. ("Heartland"), a company formed by Ruffle and PM-2.[2] Ruffle owned 70% of Heartland (with PM-2 owning the

[2] Through an employee-sharing or "secondment" arrangement, Ruffle and PM-2 were engaged by Martin Currie to serve as portfolio managers for the China Fund and Hedge Fund, respectively, along with other

remaining 30%), which received 50% of the fee revenues earned by Martin Currie for the investments Ruffle and PM-2 managed on assets raised after the establishment of the joint venture and 15% for the assets originating before the joint venture.

7. During the relevant time period, Ruffle oversaw one-third of Martin Currie's total assets under management and reported directly to the firm's chief executive officer in Edinburgh, bypassing the normal chain of command that applied to all other investment managers. Ruffle, however, remained subject to the oversight of Martin Currie's compliance, legal, and risk functions.

8. In addition, during the relevant time period, Ruffle was involved in Martin Currie's and the China Fund's application to the Commission for an order under Rule 17d-1 under the Investment Company Act to allow the China Fund to co-invest in unlisted Chinese companies with certain other accounts managed by Martin Currie, which the application described as including private funds.

B. Summary of the Hedge Fund's Equity and Bond Investments in Jackin

9. This case arises from a series of investments by Martin Currie clients in Jackin, a Chinese company engaged primarily in the printer cartridge recycling business. Jackin held this business through a chain of wholly-owned subsidiaries, including Ugent and Afex. Commencing in 1997 and during the 2000s, certain clients managed by MCIM and Ruffle made investments in various parts of Jackin's capital structure, including the transactions described below.

10. The Hedge Fund purchased equity shares in Jackin in 2003 and remained a shareholder until mid-2010. In June 2007, Ruffle caused the Hedge Fund to purchase bonds from Jackin for a principal amount of HK$78 million ($10 million) that bore a coupon rate of 10% and matured in 2010 (the "Jackin 10% Bond(s)"). These bonds were secured by equity shares of Afex, Jackin's operations subsidiary, and also included detachable warrants that were convertible into Jackin stock. This was the first-ever bond and unlisted investment by the Hedge Fund.

C. Heightened Concerns Over the Hedge Fund's Jackin Investments

11. As the global financial crises deepened in 2008, the Hedge Fund faced a significant increase in redemption requests by investors, including U.S. investors. To meet those requests, Ruffle began selling down the liquid portion of the fund's portfolio. Those sales impacted the Hedge Fund's relative exposure to the illiquid securities that remained in its portfolio.

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accounts. At all relevant times, Ruffle and PM-2 were associated persons of Martin Currie and were subject to Martin Currie's policies and procedures.

12. By the end of August 2008, the Hedge Fund's total exposure to Jackin (both equity and bonds) stood at about 14% of its net assets. In October 2008, Jackin needed an additional infusion of cash and Ruffle directed the Hedge Fund to purchase more bonds from Jackin, this time with a coupon rate of 15% and a principal amount of HK$31.2 million ($4 million) (the "Jackin 15% Bond(s).").[3]

13. These bond purchases increased the Hedge Fund's total investment in Jackin to $17 million at a time when the fund's net assets had fallen to about $92 million, due to the market downturn. As a result, the Hedge Fund's total exposure to Jackin reached about 18.5% of its portfolio, close to the fund's 20% exposure limit to any one issuer.

14. The Hedge Fund also faced severe liquidity issues due to mounting investor redemption requests as a result of the financial crisis. In November 2008, Martin Currie employees in Edinburgh became alarmed about the Hedge Fund's situation and raised with Ruffle their concerns about the fund's liquidity and exposure to Jackin. Later that month, the Hedge Fund's board gave instructions to the firm and Ruffle to "significantly" reduce the Hedge Fund's illiquid exposure to Jackin, preferably by the time of the next board meeting, in mid-February 2009.

D. The China Fund's Involvement in "Project Ink"

15. During this time, Ruffle had already been involved in negotiating a transaction in which an independent private equity fund would lead a consortium of investors in purchasing 100% of the equity of Jackin's subsidiary, Ugent, the holding company of Afex. Those negotiations began in July 2008. As contemplated, the China Fund would be a minority participant in the consortium.

16. The proposed deal, named "Project Ink," called for the repayment of the Jackin 10% Bonds held by the Hedge Fund, which were secured by the shares of Afex. Thus, the deal was considered by Ruffle to be an "exit strategy" out of the Hedge Fund's bond investment in Jackin. Any investment in Ugent necessarily required a release of the Hedge Fund's lien – acquired through the Jackin 10% Bonds – over the shares of Ugent's operating subsidiary, Afex. Only the redemption of those Jackin bonds would enable that release. In other words, because the Jackin 10% Bonds had a lien over Afex's shares, the repayment of those bonds was a necessary component of the contemplated transaction. But because the transaction would have involved the China Fund in reducing the Hedge Fund's exposure to Jackin, the deal proposed a conflict of interest between the two clients and would have been a prohibited joint arrangement absent a Commission order.

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[3] These bonds were secured by a personal guarantee from Jackin's chairman/managing director, who also held over 20% of Jackin's equity.

E. Edinburgh's "Working Group"

17. In response to the significant concerns of the Hedge Fund's board regarding the fund's illiquid exposure to Jackin, an internal "working group" (the "Working Group") was formed at Martin Currie's headquarters in Edinburgh to explore options for reducing that exposure. The Working Group consisted of senior Martin Currie officials who oversaw Martin Currie's China operations and its risk, legal, and compliance functions. Ruffle was not part of the Working Group.

18. On December 1, 2008, the Working Group convened in Edinburgh to discuss the risks posed by the Hedge Fund's concentration in Jackin and the significant redemption requests, which, if eventually paid, would exacerbate that concentration. The Working Group discussed Project Ink as a possible "exit strategy" and the China Fund's involvement in the contemplated deal. Although considered a viable "exit strategy," there were concerns that the Project Ink transaction would not address the Hedge Fund's pressing liquidity problems as it was slated to close in March 2009, after the fund's redemptions came due in January/February. As such, the group also discussed directly crossing the Jackin bonds to other Martin Currie clients, including the China Fund. The group's immediate reaction to any involvement by the China Fund was negative due to "affiliation rules."

19. The next day, the Working Group reached the consensus that the China Fund's involvement – either in Project Ink or a direct purchase of the Jackin bonds – did not pass the Working Group's collective "smell test" because of the conflict of interest. On December 3, 2008, on the eve of the China Fund's regularly scheduled board meeting, a member of the Working Group emailed Ruffle, PM-2, and Martin Currie's client services director on the need to obtain a conflict waiver from the China Fund's board if Project Ink was to proceed, noting that the deal "may not be able to go ahead due to affiliation rules" that the China Fund must abide by and that "we will need to run this by CHN's legal counsel for approval."

20. As Ruffle would not be participating in the China Fund's board meeting,[4] Ruffle then forwarded the email he had received from the member of the Working Group to PM-2. Ruffle noted that Martin Currie was now questioning whether the China Fund could make the investment due to "affiliation rules" and directed PM-2 to disclose that two MCIM clients held equity stakes in Jackin. Ruffle did not instruct PM-2 to disclose to the board the fact that Project Ink resulted in the redemption of the Jackin 10% Bonds held by the Hedge Fund.

F. The China Fund's December 4, 2008 Board Meeting

21. The China Fund board briefing on December 4, 2008, was flawed in design and execution. Despite the importance of obtaining a conflict waiver for Project Ink and Martin

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[4] Given their residencies in Shanghai, Ruffle and PM-2 alternated their attendance for the quarterly board meetings of the China Fund. It was PM-2's scheduled turn to attend the meeting on December 4, 2008, which was held in North Carolina.

Currie's fiduciary obligation to make full disclosure, Martin Currie failed to send any employees with adequate knowledge of the facts and circumstances. The only Martin Currie employees at the meeting were PM-2 and a client services director, neither of whom had as full a grasp of the Hedge Fund's problems and the conflicts presented by the Project Ink transaction as Ruffle and the Working Group. Nonetheless, neither Ruffle nor any members of the Working Group participated in the board briefing, even by telephone.

22. In preparation for the board meeting, a "pipeline" report describing Project Ink was included in the board's materials. That report, which was drafted by Ruffle, stated that Jackin would use the investment proceeds for "working capital for business expansion;" however, it failed to disclose that some of those proceeds would be used to redeem the Jackin 10% Bonds held by the Hedge Fund.

23. There was also a brief discussion of Project Ink by PM-2 at the board meeting, but PM-2 only mentioned the Hedge Fund's preexisting equity interest in Jackin, as instructed by Ruffle, not the redemption of the Jackin 10% Bonds, which was the reason Martin Currie was purportedly seeking a conflict waiver. As a result of the Hedge Fund's preexisting equity interests in Jackin, the China Fund's board provided a conflict waiver for Project Ink, an equity transaction, conditioned on the approval of its outside lawyer ("Lawyer A"). The board instructed Lawyer A to further discuss the deal with PM-2 and review the relevant deal documents.

24. Accordingly, the next morning, Lawyer A received Project Ink's term sheet and Memorandum of Understanding (MOU). These documents did not specifically disclose that the China Fund's investment in Project Ink involved the redemption of the Jackin 10% Bonds held by the China Fund's affiliate, the Hedge Fund. Later that same morning, PM-2 and Lawyer A briefly discussed Project Ink over breakfast, but PM-2 did not mention the redemption of the Jackin bonds.

25. On December 8, 2008, Lawyer A emailed his approval of Project Ink to Ruffle, PM-2, and other employees of Martin Currie, including a key member of the Working Group who knew about the conflict of interest. Lawyer A's recitation of the facts in the email upon which he based his approval of the transaction made clear his lack of awareness of the redemption of the Hedge Fund's Jackin 10% Bonds. Lawyer A concluded his email with the following condition: "This conclusion is based on my understanding of the transaction. . . . Please let me know if I have misunderstood any of the facts or mischaracterized any of the factors." No one, including Ruffle and the key member of the Working Group, corrected Lawyer A's misunderstanding or forwarded his email to others in the Working Group.

G. The Ugent Convertible Bond Transaction

26. In January 2009, Project Ink collapsed because the private equity fund that led the consortium decided to withdraw. At this point, Ruffle negotiated a new deal involving only the China Fund investing in Jackin's subsidiary, Ugent. The new deal contemplated that the China Fund itself would buy HK$177 million ($22.8 million) in Ugent bonds that were

convertible to common shares representing approximately 30% of Ugent. Ugent would then loan 44% of the investment proceeds ($10 million) to its parent, Jackin, to redeem the Hedge Fund's Jackin 10% Bonds in full, as was contemplated in Project Ink. The convertible bond deal would also enable Jackin to service its debt payments to the Hedge Fund on the Jackin 15% Bonds.

27. Although the China Fund was now investing alone in a completely new transaction (convertible bonds, not equity), Martin Currie and Ruffle did not seek additional approval or a conflict waiver from the China Fund's board or another opinion from Lawyer A.

H. The China Fund's March 26, 2009 Board Meeting

28. The next quarterly board meeting of the China Fund took place in New York on March 26, 2009. Ruffle attended the meeting as did Lawyer A. As part of the board's meeting materials, Ruffle drafted a "pipeline" report for the Ugent convertible bond transaction. That report stated that the China Fund "will buy a convertible bond [from Ugent], to provide working capital for business expansion," but again omitted the fact that 44% of the proceeds would be used to redeem the Jackin 10% Bonds. Although this was the last board meeting prior to the Ugent deal closing, Ruffle failed to disclose the redemption of the Jackin 10% Bonds at the meeting.

29. At the end of the meeting, the China Fund's board agreed to escrow approximately $22.8 million to complete the investment and authorized Ruffle and Martin Currie to proceed with the Ugent convertible bond transaction.

I. The Ugent Transaction Closes

30. The Ugent convertible bond transaction closed on April 6, 2009. The China Fund purchased the Ugent bonds for $22.8 million. Pursuant to the subscription agreement, Ugent loaned $10 million to its parent, Jackin, which then redeemed at par the Jackin 10% Bonds held by the Hedge Fund, thereby alleviating the Hedge Fund's liquidity and exposure concerns. Moreover, the remaining $12.8 million in China Fund proceeds provided working capital to Jackin, which was used in part to make debt service payments to the benefit of the Hedge Fund and the other MCIM-managed account that continued to hold Jackin bonds and stock.

31. As illustrated below, this deal was, in effect, a structured crossing transaction in which the China Fund transferred $10 million in cash to the Hedge Fund, an affiliated client, through Jackin:[5]

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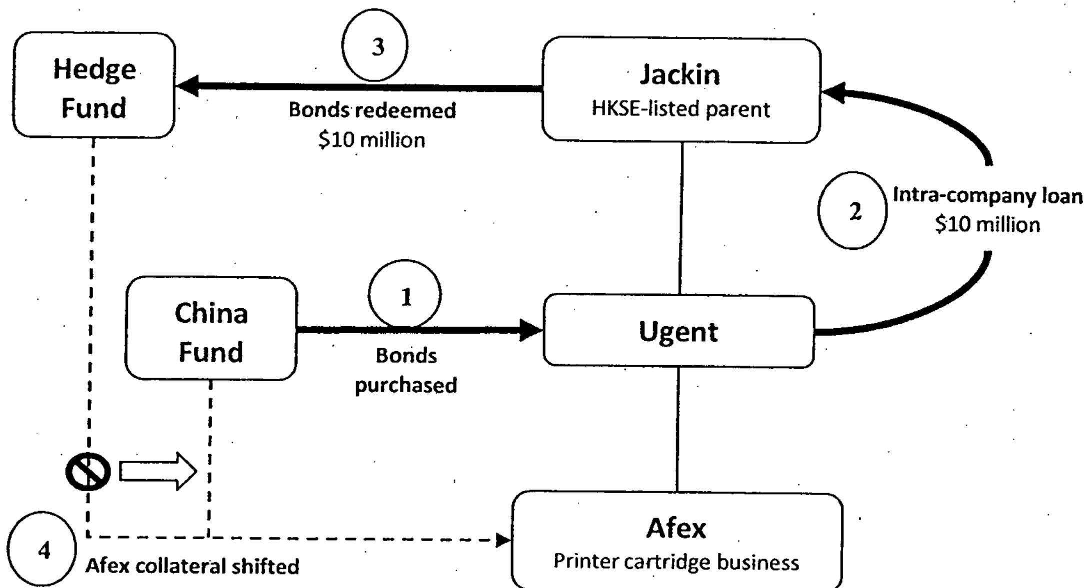
[5] In Step 1 of the diagram, the China Fund purchased the Ugent convertible bonds. In Step 2, Ugent instantaneously transferred to Jackin, via an intra-company loan, $10 million of the China Fund's investment proceeds. As Step 3 illustrates, Jackin immediately used the $10 million to redeem the Hedge Fund's Jackin 10% Bonds. Step 4 shows the movement of collateral. The Hedge Fund's bonds had been secured by equity shares of Afex, Jackin/Ugent's operations subsidiary. Upon redemption of the Jackin 10% Bonds, the Afex collateral was transferred to serve as security for the Ugent convertible bonds held by the China Fund.



32. In October 2010, 19 months after the convertible bond transaction closed, the China Fund's board determined to write down the value of the Ugent bonds by 50% of their face value. In November 2010, the China Fund's board wrote down the value of the Ugent bonds to zero. Ultimately, in April 2011, the China Fund sold the Ugent Bonds for 55% of their face value.

Violations

A. Investment Company Act Joint Transaction and Arrangement Provision – Section 17(d) and Rule 17d-1 Thereunder

33. Section 17(d) of the Investment Company Act prohibits any affiliated person of a registered investment company or any affiliated person of such affiliated person (or each, an "affiliate"), acting as principal, from effecting any transaction in which such registered investment company is a joint or a joint and several participant with such affiliate in contravention of such rules and regulations as the Commission may prescribe. Section 17(d) is intended to limit or prevent participation by such registered company on a basis different from or less advantageous than that of another participant. Rule 17d-1 under the Investment Company Act prohibits any such affiliate from participating in any joint enterprise, other joint arrangement, or profit-sharing plan (a "joint arrangement") unless it obtains a Commission order.

34. Ruffle willfully[6] aided and abetted and caused violations of Section 17(d) of the Investment Company Act and Rule 17d-1 by causing the Hedge Fund, an affiliate of the China Fund, to participate in a joint arrangement with the China Fund without a Commission order when he knew that the transaction involved the redemption of the Jackin 10% Bonds and knew (or was reckless in not knowing) that the transaction raised affiliation concerns.

IV.

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

Accordingly, pursuant to Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Ruffle cease and desist from committing or causing any violations and any future violations of Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder.

B. Respondent Ruffle is 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 for a period of twelve (12) months, effective on the second Monday following the entry of this Order.

C. Respondent Ruffle shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $150,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

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

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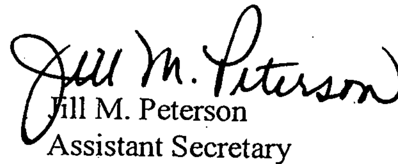
6 A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Christopher B. Ruffle as Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Jeffrey B. Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Mail Stop 5010, Washington, DC 20549-5010.

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. 72289 / June 2, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15899

In the Matter of

S. PAUL KELLEY,

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 S. Paul Kelley ("Kelley" or "Respondent").

II.

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

III.

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

1. Kelley has never been registered with the Commission as a broker-dealer or associated with a registered broker-dealer, and for at least a portion of the time in which Kelley engaged in the conduct underlying the complaint described further below, he acted as an unregistered broker-dealer. Further, Kelley participated in offerings of penny stocks issued by publicly listed shell companies that, after reverse mergers and name changes, became China Auto Logistics, Inc. ("China Auto") and Guanwei Recycling Corp. ("Guanwei"). Kelley, 49 years old, is a citizen of Canada.

2. On May 12, 2014, a final judgment was entered by consent against Kelley, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 9(a), 10(b), 13(d), 15(a), and 16(a) of the Exchange Act and Rules 10b-5, 13d-1, 13d-2, and 16a-3 thereunder, and Rule 101 of Regulation M thereunder, in the civil action entitled Securities and Exchange Commission v. S. Paul Kelley, et al., Civil Action Number 2:14-cv-02827 SRC-CLW, in the United States District Court for the District of Colorado. Under the final judgment, Kelley is liable to pay disgorgement in the amount of $2,828,353.53, plus prejudgment interest thereon in the amount of $560,812.47, and Kelley is liable to pay civil penalties in the amount of $2,828,353.53.

3. The Commission's complaint alleged that Kelley engaged in a scheme to take China Auto and Guanwei public through reverse mergers with public shell companies, and then manipulate the trading of the issuers. Specifically, the complaint alleged that Kelley structured the acquisition of public shell companies and their respective reverse merger transactions with China Auto and Guanwei to control the free trading shares in the stocks, and then orchestrated manipulative trading to artificially inflate the issuers' price, to facilitate their listing on national securities exchanges. The complaint also alleged that Kelley did not disclose certain securities holdings and transactions, sold unregistered securities, acted as an unregistered broker-dealer, and while distributing the securities and while the distributions were ongoing, he purchased the offered securities.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Kelley 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, with the right to apply for reentry after five years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association or participation 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
Assistant Secretary

Commissioner Piwowar Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72290 / June 2, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3842 / June 2, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15900

In the Matter of **JOHN J. BRAVATA,** **RICHARD J. TRABULSY, and** **ANTONIO M. BRAVATA,** **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, AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against John J. Bravata ("John Bravata"), Richard J. Trabulsy ("Trabulsy"), and Antonio M. Bravata ("Antonio Bravata") (collectively, "Respondents"), and pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against John Bravata and Trabulsy.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. John Bravata, age 46, is formerly a resident of Brighton, Michigan, and is currently incarcerated at a federal prison in Loretto, Pennsylvania. During the period May 2006 through July 2009, John Bravata was a manager, co-founder, and the Chairman of BBC Equities,

LLC ("BBC Equities"), a purported real estate investment fund, and Bravata Financial Group, LLC ("Bravata Financial"), an unregistered life insurance and financial planning company. On October 3, 2008, Bravata Financial filed an application for registration as a broker-dealer with the Commission. Bravata Financial abandoned that application in December 2009. For a portion of the time in which John Bravata engaged in the conduct underlying the complaint and indictment described below, he was associated with and a co-owner of Strategic Institutional Consulting Group, LLC ("Strategic Consulting"), an investment adviser that was registered with the Commission from April 27, 2009 through July 30, 2009.

2. Trabulsy, age 31, is a resident of Troy, Michigan. During the period May 2006 through July 2009, Trabulsy was a manager, co-founder, and the Vice Chairman of BBC Equities and Bravata Financial. For a portion of the time in which he engaged in the conduct underlying the complaint and indictment described below, Trabulsy was associated with and a co-owner of Strategic Consulting.

3. Antonio Bravata, age 26, is formerly a resident of Brighton, Michigan, and is currently incarcerated at a federal prison in Schuylkill, Pennsylvania. For a portion of the time in which Antonio Bravata engaged in the conduct underlying the complaint and indictment described below, he was an employee of Bravata Financial.

B. ENTRY OF INJUNCTIONS AGAINST RESPONDENTS

4. On March 3, 2014, the court granted the Commission's motion for summary judgment and entered a judgment permanently enjoining Respondents from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. John J. Bravata, et al., No. 09-cv-12950, in the United States District Court for the Eastern District of Michigan.

5. The Commission's amended complaint alleged that from May 2006 through July 2009, Respondents engaged in a fraudulent and unregistered securities offering that raised at least $50 million from at least 440 investors in Michigan, Ohio and other states by selling BBC Equities securities. The Commission's amended complaint further alleged that Respondents defrauded BBC Equities investors by, among other things, making misrepresentations about the use of investor funds; the risks associated with the investment; the purported compensation, commissions, and finder's fees paid to them and others; and the true financial condition of BBC Equities. The amended complaint also alleged that Respondents acted as unregistered broker-dealers.

C. ENTRY OF THE RESPONDENTS' CRIMINAL CONVICTIONS

6. On March 27, 2013, after a trial, a jury found John Bravata guilty of 14 counts of wire fraud, 18 U.S.C. § 1343, and one count of conspiracy to commit wire fraud, and found Antonio Bravata guilty of one count of conspiracy to commit wire fraud, in U.S. v. John Bravata, et al., 2:11-cr-20314 (E.D. Mich.)

7. On September 25, 2013, a judgment was entered in the criminal case against John Bravata. He was sentenced to 240 months in prison and ordered to pay approximately $44.5 million in restitution. On October 10, 2013, a judgment was entered in the criminal case against Antonio Bravata. Antonio Bravata was sentenced to 60 months in prison and ordered to pay approximately $7 million in restitution.

8. On January 14, 2014, Trabulsy pleaded guilty to one count of wire fraud, 18 U.S.C. § 1343, in U.S. v. Richard Trabulsy, 2:11-cr-20314 (E.D. Mich.). On April 15, 2014, a judgment was entered in the criminal case against Trabulsy. Trabulsy was sentenced to 45 months in prison and ordered to pay $44,533,436 in restitution.

9. The counts of the superseding indictment on which Respondents were criminally convicted alleged, among other things that John Bravata, Trabulsy, and Antonio Bravata defrauded investors and engaged in wire fraud and/or conspiracy in connection with the fraudulent sale of the BBC Equities securities that were the subject of the Commission's amended complaint described in Paragraph 5 above.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against John Bravata and Trabulsy pursuant to Section 203(f) of the Advisers Act.

IV.

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

IT IS FURTHER ORDERED that Respondents shall each file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If any of the Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally 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. 72295 / June 2, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15901

In the Matter of **Advanced Water Technology Holdings, Inc., Creative Entertainment Holdings, Inc., DRI Corporation (n/k/a Xdric, Inc.), International Paintball Association, Inc., and Sherwood Acquisition Corporation,** **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 Advanced Water Technology Holdings, Inc., Creative Entertainment Holdings, Inc., DRI Corporation (n/k/a Xdric, Inc.), International Paintball Association, Inc., and Sherwood Acquisition Corporation.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Advanced Water Technology Holdings, Inc. (CIK No. 1439570) is a void Delaware corporation located in San Bruno, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Advanced Water Technology Holdings, Inc. 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 $56,708 since the company's June 16, 2008 inception.

2. Creative Entertainment Holdings, Inc. (CIK No. 1522212) is a void Delaware corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Creative Entertainment Holdings, Inc. 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 $750 since the company's April 20, 2011 inception.

3. DRI Corporation (n/k/a Xdric, Inc.) (CIK No. 853695) is a North Carolina corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DRI Corporation was acquired by Luminator Technology Group on July 16, 2012. DRI Corporation 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 $10,004,000 for the prior nine months. On March 25, 2012, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of North Carolina, and the case was still pending as of March 10, 2014.

4. International Paintball Association, Inc. (CIK No. 1446801) is a Colorado corporation located in Southlake, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). International Paintball Association, Inc. 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.

5. Sherwood Acquisition Corporation (CIK No. 1502658) is a forfeited Delaware corporation located in Newport Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sherwood Acquisition Corporation 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 $2,250 since the company's July 19, 2010 inception. On August 2, 2001, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of California; the case is now closed.

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
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72301 / June 3, 2014

WHISTLEBLOWER AWARD PROCEEDING
File No. 2014-5

In the Matter of the Claim for Award

in connection with
Redacted

Redacted
Notice of Covered Action Redacted

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

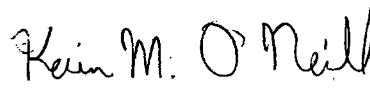
On April 7, 2014, the Claims Review Staff issued a Preliminary Determination related to Notice of Covered Action Redacted (the "Covered Action"). The Preliminary Determination recommended that Claimant #1 and Claimant #2 each receive a whistleblower award because, acting in concert, they voluntarily provided original information to the Commission that led to the successful enforcement of the Covered Action pursuant to Section 21F(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78u-6(b)(1), and Rule 21F-3(a) thereunder, 17 C.F.R. § 240.21F-3(a). Further, the Claims Review Staff recommended that such award be set in the amount of thirty percent (30%), in total, (split evenly at 15% each) of the monetary sanctions collected or to be collected in the Covered Action. In arriving at this recommendation, the Claims Review Staff considered the factors set forth in Rule 21F-6, 17 C.F.R. § 240.21F-6, in relation to the facts and circumstances of Claimant #1's and Claimant #2's applications.

On April 7, 2014, Claimant #1 and Claimant #2 provided written notice to the Commission of their decisions not to contest the Preliminary Determination within the 60-day deadline set out in Rule 21F-10(e) promulgated under the Exchange Act, 17 C.F.R. § 240.21F-10(e), and, pursuant to Rule 21F-10(f) thereunder, 17 C.F.R. § 240.21F-10(f), the Preliminary Determination became the Proposed Final Determination of the Claims Review Staff.

Upon due consideration under Rule 21F-10(f) and (h), 17 C.F.R. § 240.21F-10(f) and (h), and for the reasons set forth in the Proposed Final Determination, it is hereby ORDERED that Claimant #1 and Claimant #2 shall each receive an award of fifteen percent (15%) for a total of thirty percent (30%) of the monetary sanctions collected in this Covered Action, including any

monetary sanctions collected after the date of this Order.[1]

By the Commission.



Kevin M. O'Neill
Deputy Secretary

[1] A portion of the disgorgement and prejudgment interest ordered to be paid in the Covered Action was "deemed satisfied" by Respondents' payment of that amount pursuant to a civil action brought by Redacted

Redacted

and shall be included in our calculation of the award payment to the claimants here. We interpret Section 21 F(b)(1) of the Exchange Act, which provides for payment of awards based on "what has been collected of the monetary sanctions" imposed in a Commission Covered Action, to include amounts that are deemed satisfied when collected in actions brought by other governmental authorities.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9592 / June 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15902

In the Matter of Erik T. Voorhees, Respondent.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

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

II.

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

III.

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

Summary

These proceedings arise out of unregistered offerings of shares of FeedZeBirds and SatoshiDICE, two separate entities co-owned by Voorhees and others. Voorhees is a well-known Bitcoin proponent, and the shares were offered and sold in exchange for bitcoins, commonly referred to as "virtual currency."[1] Bitcoin is a decentralized peer-to-peer payment network; bitcoin transactions are recorded by the network on an electronic public ledger known as the "block chain." Bitcoins can be used to purchase real-world goods and services and can be exchanged for fiat currencies on certain online exchanges. From May 2012, the time of the first offering, to the present, the exchange rate of U.S. dollars ("USD") to bitcoins has fluctuated between a low of approximately $5 per bitcoin and a high of approximately $1,200 per bitcoin.

In May 2012, FeedZeBirds offered and sold 30,000 shares, and raised 2,600 bitcoins in connection with that unregistered offer and sale. At the time of the FeedZeBirds offering, the USD value of the bitcoins raised was approximately $15,000. From August 2012 through February 2013, in two separate offerings, SatoshiDICE offered and sold 13 million shares, and raised 50,600 bitcoins in connection with those unregistered offers and sales. At the time of the SatoshiDICE offerings, the USD value of the total bitcoins raised was approximately $722,659. In July 2013, SatoshiDICE bought back all outstanding SatoshiDICE shares from investors at a price of 0.0035 bitcoins per share, for a total of 45,500 bitcoins. Due to the significant rise in the exchange rate of bitcoin, the total USD amount paid to investors in the SatoshiDICE buy-back transaction (approximately $3.8 million) exceeded the total USD amount raised.

Respondent and Relevant Entities

1. **Voorhees**, age 29, is a U.S. citizen who, at the time of the FeedZeBirds and SatoshiDICE offerings, was living in the United States.

2. **FeedZeBirds** is not a registered corporation. FeedZeBirds purports to pay individuals who use Twitter, an online text messaging service, a fee in bitcoins in exchange for

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[1] For purposes of this Order, a "virtual currency" is a digital representation of value that can be digitally traded and functions as a medium of exchange; a unit of account; and/or a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued or guaranteed by any jurisdiction, and fulfills the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinct from fiat currency, which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It also is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency, i.e., e-money electronically transfers value that has legal tender status.

forwarding sponsored text messages. During the relevant time period, Voorhees co-owned FeedZeBirds, which had a website (feedzebirds.com) that launched in November 2011.

3. **SatoshiDICE** is not a registered corporation. SatoshiDICE purports to be a gambling website that takes bets and pays out winnings in bitcoins. Voorhees launched the SatoshiDICE website (satoshidice.com) in April 2012, and co-owned the company until July 2013, when he and the other co-owners sold it.

Offering of FeedZeBirds Shares

4. On May 24, 2012, FeedZeBirds offered 30,000 shares, representing 30% of the company, priced at 0.08667 bitcoins per share.[2] The shares were listed on an entity known as the Global Bitcoin Stock Exchange ("GLBSE"), which purported to run a Bitcoin stock exchange.[3]

5. Voorhees published a prospectus for the FeedZeBirds offering, which he made publicly available on the Internet. The prospectus was never filed with the Commission. In addition, Voorhees made general solicitations to sell FeedZeBirds shares over the Internet, which included posts on an internet website dedicated to Bitcoin known as the Bitcoin Forum (bitcointalk.org), on Facebook.com, and on other Bitcoin-related websites.

6. For example, prior to the offering, on May 21, 2012, Voorhees posted on the Bitcoin Forum the following: "FeedZeBirds.com (http://FeedZeBirds.com), the Bitcoin Twitter advertising platform with nearly 3,000 users and over 40,000,000 ad impressions served thus far, is launching shares on Thursday, May 24, at 15:30 EST via GLBSE.com." (Emphasis removed from original.)

7. Also on May 21, 2012, the website FreedomsPhoenix.com posted the following announcement titled "FeedZeBirds IPO":

> FeedZeBirds is proud to announce that you can now own a piece of feedzebirds.com. On Thursday, May 24, at 15:30 EST FeedZeBirds will release 30% of the company as 30,000 shares on GLBSE, the Bitcoin stock exchange .... A share will be sold at 0.08667 BTC each."

8. The FeedZeBirds offering raised 2,600 bitcoins. At the time of the offering, 2,600 bitcoins were worth approximately $15,000.

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[2] One bitcoin is divisible into 100,000,000 units, with the smallest unit (0.0000001 bitcoin) called a "Satoshi."

[3] In October 2012, GLBSE ceased operations.

Offerings of SatoshiDICE Shares

9. In a first SatoshiDICE offering, which took place from August 2012 through January 2013, SatoshiDICE offered and sold 10 million shares, which represented a 10% interest in the company. SatoshiDICE offered these shares in three separate tranches at prices between 0.0032 and 0.0037 bitcoins per share. The shares of SatoshiDICE were listed on MPEx, a purported Bitcoin trading platform based in Romania.

10. Voorhees published a prospectus for this first SatoshiDICE offering, which he made widely available on the Internet. According to a summary prospectus, SatoshiDICE sought to "raise IPO capital through an equity offering on the MPEx platform by releasing 10% of its 100,000,000 shares. Starting from the first full calendar month after the IPO, shares will pay dividends equal to 100% of SatoshiDICE net profits ...." The prospectus was never filed with the Commission.

11. In addition, Voorhees made general solicitations over the Internet, which included posts on the Bitcoin Forum, on Facebook.com, and on other Bitcoin-related websites.

12. According to the prospectus and statements made by Voorhees, 10% of the funds raised in the offering would be used on a "high profile print marketing campaign in European gaming publications." Voorhees also posted on the Bitcoin Forum that he planned to use the remaining proceeds to fund two undisclosed startups. Finally, the prospectus included statistics about SatoshiDICE's earnings and expenses.

13. The first SatoshiDICE offering raised 34,500 bitcoins. At the time of the offering, 34,500 bitcoins were worth approximately $371,910.

14. In a second SatoshiDICE offering, which took place in February 2013, SatoshiDICE offered and sold an additional 3 million of its shares at prices between 0.0044 and 0.0062 bitcoins per share, which raised 16,100 bitcoins. At the time of this second offering, 16,100 bitcoins were worth approximately $337,827.

15. On July 17, 2013, Voorhees announced on the Bitcoin Forum that SatoshiDICE was being sold and that in anticipation of the sale, SatoshiDICE would buy back all outstanding shares from investors. Voorhees posted that SatoshiDICE would buy the shares at 0.0035 bitcoins per share, which was at a 277% premium over the per share price that SatoshiDICE received in the sale of the company and roughly a 175% premium over the current market price of the SatoshiDICE shares listed on MPEx.

16. Just prior to the sale, SatoshiDICE bought back all 13 million outstanding SatoshiDICE shares from investors at a price of 0.0035 bitcoins per share, for a total of 45,500 bitcoins. Due to the significant rise in the exchange rate of bitcoin, the total USD amount paid to investors in the buy-back transaction (approximately $3.8 million) exceeded the total USD amount raised (approximately $722,659).

17. On July 18, 2013, Voorhees announced on the Bitcoin Forum that the buy-back had been completed, SatoshiDICE had been sold to a private party and that shares of SatoshiDICE had been "delisted."

18. No registration statement was filed for the FeedZeBirds or SatoshiDICE offerings, and no exemption from registration was applicable to these transactions.

19. Voorhees used the Internet in connection with these offers and sales of FeedZeBirds and SatoshiDICE shares.

20. As a result of the conduct described above, Voorhees violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the direct or indirect sale of securities, offer to sell or offer to buy securities through the mails or interstate commerce unless a registration statement has been filed or is in effect.

Undertaking

Respondent has undertaken to:

Forgo directly or indirectly, including, but not limited to, through any entity owned or controlled by Respondent, participating in any issuance of any security in an unregistered transaction, in exchange for bitcoins or other virtual currency, for a period of five years.

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 8A of the Securities Act, Respondent cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act.

B. Respondent shall comply with the undertaking enumerated in Section III above.

C. Respondent shall, within twenty (20) days of the entry of this Order, pay disgorgement of $15,000 and prejudgment interest of $843.98 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

C. Respondent shall, within twenty (20) days of the entry of this Order, pay civil money penalties of $35,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

D. The foregoing payments 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 Erik T. Voorhees 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 Valerie A. Szczepanik, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281-1022.

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9595 / June 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15905

In the Matter of **the Registration Statement of** **Diamond Lane, Inc.** **2501 East Aragon Blvd, Suite 1** **Sunrise, FL 33313** **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 August 28, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $30,000 public offering. The registration statement was amended on September 30, 2013, and October 21, 2013.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent is a Florida corporation headquartered in Sunrise, Florida.

2. On August 28, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $30,000 public offering. The registration statement was amended on September 30, 2013, and October 21, 2013 (together, the "Registration Statement").

B. MATERIAL MISSTATEMENTS AND OMISSIONS

3. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading, for example:

a. The Registration Statement states that "[o]ur sole officer and director will be responsible for the business plan" to develop and sell a mobile consumer application. The Registration Statement also states that Respondent "is entirely dependent on the efforts of our sole officer and director." The Registration Statement further states that Respondent is "currently operating out of our sole director and officer's office located at 2501 East Aragon Blvd, Suite 1, Sunrise, FL 33313." These disclosures are untrue and misleading because Respondent's sole officer and director has not engaged in any business activities for Respondent.

b. The Registration Statement states that the "Board of Directors is comprised [ ] solely of [Respondent's sole officer and director] who was integral to our business and who is involved in our day to day operations." The Registration Statement also states that Respondent's sole officer and director "currently devotes 25 to 30 hours per week to our business" and "is prepared to devote more time to our operations." The Registration Statement further states that "[t]he functions of [an Audit Committee, a Compensation Committee or a Nominating Committee] are being undertaken by our sole director." These disclosures are untrue and misleading because Respondent's sole officer and director has had no involvement in, and spent no time on, Respondent's operations.

c. The Registration Statement states that Respondent's sole officer and director "meet[s] the conditions of paragraph (a)(4)(ii) of Rule 3a4-1 of the Exchange Act, in that [he] (A) primarily perform[s], or is intended primarily to perform at the end of the offering, substantial duties for or on behalf of our Company, other than in connection with transactions in securities . . . ." These disclosures are untrue and misleading because Respondent's sole officer and director has not performed and does not intend to perform substantial duties for or on behalf of Respondent.

d. The Registration Statement states that "[t]he shares will be sold on our behalf by our officer" and that "[i]t is our belief [Respondent's sole officer and director] had such knowledge and experience in financial and business matters that he was capable of evaluating the merits and risks of the investment and therefore did not need the protections offered their [sic] shares under Securities and Act of 1933 [sic], as amended. [Respondent's sole officer and director] certified that he was purchasing the shares for their [sic] own accounts, with investment intent." These disclosures are untrue and misleading because Respondent's sole officer and director does not have any knowledge of the shares, does not plan to sell the shares, does not have the described knowledge or experience in financial or business matters, and made no such certification.

e. The Registration Statement claims that there was a capital contribution by Respondent's sole officer and director on June 19, 2013. This disclosure is untrue and misleading because Respondent's sole officer and director made no such capital contribution and has not received any shares related to Respondent.

f. The Registration Statement states that "[p]ursuant to the requirements of the Securities Act, the registrant has duly caused this registration statement to be signed on its behalf by [Respondent's sole officer and director]." This disclosure is untrue and misleading because Respondent's sole officer and director did not sign the Registration Statement.

g. The Registration Statement states that Respondent has "no plans to change our business activities or to combine with another business and are not aware of any events or circumstances that might cause us to change our plans." This disclosure is untrue and misleading because Respondent has no business of its own, and is an undisclosed "blank check company" as defined in Rule 419 under the Securities Act of 1933 (the "Securities Act").

h. The Registration Statement states that Respondent's sole officer and director "is the only 'parent' and 'promoter' of the company" and will "continue to control the operations of the Company" after the offering. This disclosure is untrue and misleading because Respondent is controlled and/or promoted by undisclosed control persons and/or promoters.

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 with 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 9:30 a.m. on June 19, 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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9593 / June 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15903

In the Matter of **the Registration Statement of** **Sunchip Technology, Inc.** **2501 East Aragon Blvd, Unit 1** **Sunrise, FL 33313** **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 September 26, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 30,000,000 common shares in a $30,000 public offering.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent is a Florida corporation headquartered in Sunrise, Florida.

2. On September 26, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 30,000,000 common shares in a $30,000 public offering (the "Registration Statement").

B. MATERIAL MISSTATEMENTS AND OMISSIONS

3. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading, for example:

a. The Registration Statement states that "[o]ur sole officer and director will be responsible for the business plan" to develop and sell mobile applications. The Registration Statement also states that Respondent "is entirely dependent on the efforts of our sole officer and director." The Registration Statement further states that Respondent is "currently operating out of our sole director and officer's office located at 2501 East Aragon Blvd, Unit 1, Sunrise, FL 33313." These disclosures are untrue and misleading because Respondent's sole officer and director has not engaged in any business activities for Respondent other than opening a bank account.

b. The Registration Statement states that the "Board of Directors is comprised [ ] solely of [Respondent's sole officer and director] who was integral to our business and who is involved in our day to day operations." The Registration Statement also states that Respondent's sole officer and director "currently devotes 25 to 30 hours per week to our business" and "is prepared to devote more time to our operations." The Registration Statement further states that "[t]he functions of [an Audit Committee, a Compensation Committee or a Nominating Committee] are being undertaken by our sole director." These disclosures are untrue and misleading because Respondent's sole officer and director has had no involvement in, and spent no time on, Respondent's operations.

c. The Registration Statement states that Respondent's sole officer and director "meet[s] the conditions of paragraph (a)(4)(ii) of Rule 3a4-1 of the Exchange Act, in that [she] (A) primarily perform[s], or is intended primarily to perform at the end of the offering, substantial duties for or on behalf of our Company, other than in connection with transactions in securities . . . ." These disclosures are untrue and misleading because Respondent's sole officer and director has not performed and does not intend to perform substantial duties for or on behalf of Respondent.

d. The Registration Statement states that "[t]he shares will be sold on our behalf by our officer" and that "[i]t is our belief [Respondent's sole officer and director] had such knowledge and experience in financial and business matters that she was capable of evaluating the merits and risks of the investment and therefore did not need the protections offered their [sic] shares under Securities and Act of 1933 [sic], as amended. [Respondent's sole officer and director] certified that she was purchasing the shares for their [sic] own accounts, with investment intent." These disclosures are untrue and misleading because Respondent's sole officer and director does not have any knowledge of the shares, does not plan to sell the shares, does not have the described knowledge or experience in financial or business matters, and made no such certification.

e. The Registration Statement claims that there was a capital contribution by Respondent's sole officer and director on August 19, 2013. This

disclosure is untrue and misleading because Respondent's sole officer and director made no such capital contribution and has not received any shares related to Respondent.

f. The Registration Statement states that "[p]ursuant to the requirements of the Securities Act, the registrant has duly caused this registration statement to be signed on its behalf by [Respondent's sole officer and director]." This disclosure is untrue and misleading because Respondent's sole officer and director did not sign the Registration Statement.

g. The Registration Statement states that Respondent has "no plans to change our business activities or to combine with another business and are not aware of any events or circumstances that might cause us to change our plans." This disclosure is untrue and misleading because Respondent has no business of its own, and is an undisclosed "blank check company" as defined in Rule 419 under the Securities Act of 1933 (the "Securities Act").

h. The Registration Statement states that Respondent's sole officer and director "is the only 'parent' and 'promoter' of the company" and will "continue to control the operations of the Company" after the offering. This disclosure is untrue and misleading because Respondent is controlled and/or promoted by undisclosed control persons and/or promoters.

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 with 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 9:30 a.m. on June 19, 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.

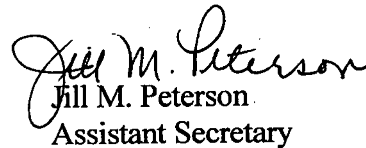
IT IS FURTHER ORDERED that these proceedings shall be presided over by an Administrative Law Judge to be designated by further order, who is authorized to perform all the duties of an Administrative Law Judge as set forth in the Commission's Rules of Practice or as otherwise provided by law.

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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9594 / June 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15904

In the Matter of **the Registration Statement of** **ShopEye, Inc.** **108 Flying Mist Isle** **Foster City, CA 94404** **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 June 20, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $30,000 public offering. The registration statement was amended on August 19, 2013, and September 4, 2013, and became effective on September 26, 2013.

II.

After an investigation, the Division of Enforcement alleges that:

A. <u>RESPONDENT</u>

1. Respondent is a Florida corporation headquartered in Foster City, California.

2. On June 20, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $30,000 public offering. The registration statement was amended on August 19, 2013, and

September 4, 2013, and became effective on September 26, 2013 (together, the "Registration Statement").

B. MATERIAL MISSTATEMENTS AND OMISSIONS

3. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading, for example:

a. The Registration Statement states that "[o]ur sole officer and director will be responsible for the business plan" to develop and sell mobile applications. The Registration Statement also states that Respondent "is entirely dependent on the efforts of our sole officer and director." The Registration Statement further states that Respondent is "currently operating out of our sole director and officer's office located at 108 Flying Mist Isle, Foster City, CA 94404." These disclosures are untrue and misleading because Respondent's sole officer and director has not engaged in any business activities for Respondent except for opening a bank account and signing certain documents.

b. The Registration Statement states that the "Board of Directors is comprised [ ] solely of [Respondent's sole officer and director] who was integral to our business and who is involved in our day to day operations." The Registration Statement also states that Respondent's sole officer and director "currently devotes 25 to 30 hours per week to our business" and "is prepared to devote more time to our operations." The Registration Statement further states that "[t]he functions of [an Audit Committee, a Compensation Committee or a Nominating Committee] are being undertaken by our sole director." These disclosures are untrue and misleading because Respondent's sole officer and director has had no involvement in, and spent no time on, Respondent's operations.

c. The Registration Statement states that Respondent's sole officer and director "meet[s] the conditions of paragraph (a)(4)(ii) of Rule 3a4-1 of the Exchange Act, in that [she] (A) primarily perform[s], or is intended primarily to perform at the end of the offering, substantial duties for or on behalf of our Company, other than in connection with transactions in securities . . . ." These disclosures are untrue and misleading because Respondent's sole officer and director has not performed substantial duties for or on behalf of Respondent.

d. The Registration Statement states that "[t]he shares will be sold on our behalf by our officer" and that "[i]t is our belief [Respondent's sole officer and director] had such knowledge and experience in financial and business matters that she was capable of evaluating the merits and risks of the investment and therefore did not need the protections offered their [sic] shares under Securities and Act of 1933 [sic], as amended. [Respondent's sole officer and director] certified that she was purchasing the shares for their [sic] own accounts, with investment intent." These disclosures are untrue and misleading because Respondent's sole officer and director does not have any

knowledge of the shares, does not have the described knowledge or experience in financial or business matters, and made no such certification.

e. The Registration Statement claims that there was a capital contribution by Respondent's sole officer and director on September 13, 2011. This disclosure is untrue and misleading because Respondent's sole officer and director made no such capital contribution and has not received any shares related to Respondent.

f. The Registration Statement states that Respondent has "no plans to change our business activities or to combine with another business and are not aware of any events or circumstances that might cause us to change our plans." This disclosure is untrue and misleading because Respondent has no business of its own, and is an undisclosed "blank check company" as defined in Rule 419 under the Securities Act of 1933 (the "Securities Act").

g. The Registration Statement states that Respondent's sole officer and director will "continue to control the operations of the Company" after the offering. This disclosure is untrue and misleading because Respondent is controlled by undisclosed control persons.

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 with 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 9:30 a.m. on June 19, 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.

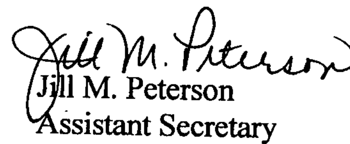
IT IS FURTHER ORDERED that these proceedings shall be presided over by an Administrative Law Judge to be designated by further order, who is authorized to perform all the duties of an Administrative Law Judge as set forth in the Commission's Rules of Practice or as otherwise provided by law.

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
Assistant Secretary

Chair White
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72303 / June 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-13673

In the Matter of J.P. MORGAN SECURITIES INC. Respondent.	ORDER AUTHORIZING THE TRANSFER OF REMAINING FUNDS AND ANY FUTURE FUNDS RETURNED TO THE FAIR FUND TO THE U.S. TREASURY, DISCHARGING PLAN ADMINISTRATOR AND TERMINATING THE FAIR FUND

On November 4, 2009, the United States Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order") against Respondent J.P. Morgan Securities, Inc. (Securities Act Rel. No. 9078 (Nov. 4, 2009)).

The Order found, among other things, that J.P. Morgan Securities, through two of its managing directors, made over $8.2 million in undisclosed payments in 2002 and 2003 to local firms whose principals or employees were friends of Jefferson County, Alabama ("County") public officials. The County officials were instrumental in selecting J.P. Morgan Securities as underwriter, and its affiliated bank as the swap provider, on over $5 billion in bond underwriting and interest rate swap agreement business awarded by the County. Pursuant to the Order, J.P. Morgan Securities was censured and ordered to cease and desist from committing or causing any violations and any future violations of the charged provisions. The Commission further ordered J.P. Morgan Securities to pay $1 in disgorgement and a $25 million civil penalty, and created a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 to distribute the disgorgement and civil penalty paid by Respondent (the "Fair Fund").

On August 18, 2010, the Commission published a Notice of Proposed Plan of Distribution and Opportunity for Comment (Exchange Act Rel. No. 62738) pursuant to Rule

1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. §201.1103. The Notice advised parties they could obtain a copy of the Distribution Plan at www.sec.gov. The Notice also advised that all persons desiring to comment on the Distribution Plan could submit their comments, in writing, no later than 30 days from the date of the Notice. No comments were received by the Commission in response to the Notice.

On October 7, 2010, the Commission issued an Order Approving Distribution Plan and Appointing a Plan Administrator (Exchange Act Rel. No. 63060). The Distribution Plan stated that monies from the Fair Fund would be distributed to Jefferson County, Alabama, which was harmed by the Respondent's conduct, as further described in the Distribution Plan. On February 1, 2011, the Commission issued an Order Directing Disbursement of a Fair Fund (Exchange Act Rel. No. 63812) providing for distribution of funds pursuant to the Distribution Plan. On February 11, 2011, the distribution of $25,033,692.30 was made to the County. All distributions have been made. An amount of $3,561.69 remains as residual funds.

Paragraph 17 of the Distribution Plan provides that the Fair Fund will be eligible for termination, and the Plan Administrator can be discharged, after: (1) the final accounting has been submitted and approved by the Commission; (2) all taxes, fees and expenses have been paid; and (3) any amount remaining in the Fair Fund has been received by the Commission. A final accounting, which has been submitted to the Commission for approval as required by Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans and as set forth in the Distribution Plan, is now approved. Staff has verified that all taxes, fees, and expenses have been paid, and the Commission is in possession of the remaining Fair Fund monies.

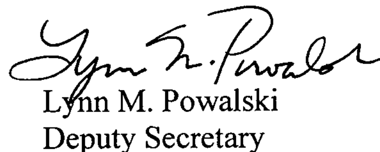
Accordingly, IT IS ORDERED that:

A. The $3,561.69 remaining in the Fair Fund, and any future funds returned to the Fair Fund, shall be transferred to the U.S. Treasury;

B. The Plan Administrator, Nichola L. Timmons, is discharged; and

C. The Fair Fund is terminated.

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. 72310 / June 4, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15906

IN THE MATTER OF PHILIP T. POWERS, 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 Philip T. Powers ("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.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. During the relevant period Respondent was a licensed attorney and held the position of senior counsel at Handler, Thayer & Duggan, LLC ("HTD"). During the relevant period, HTD was a law firm based in Chicago, Illinois. HTD, through Powers, acted as an escrow agent for several of the issuers of stock sold through an alleged boiler room scheme. HTD has never been registered with the Commission as a broker-dealer. According to CRD records, during the relevant period, Powers was not associated with a registered broker-dealer. Powers is a resident of Chicago.

2. 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.

3. 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 his services. It is further alleged that 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 HTD, 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 Philip T. Powers' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Philip T. Powers be, and hereby is:

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

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially

waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Jill M. Petersen
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72316 / June 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15907

In the Matter of FLM Minerals, Inc., Respondent.	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT [1]

1. FLM Minerals, Inc. ("FLMS") (CIK No. 1391174) is a Nevada corporation located in Beijing, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FLMS is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended August 31, 2011, which reported a net loss of $14,114 for the prior nine months. As of May 28, 2014, the common stock of FLMS was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

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

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

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

which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

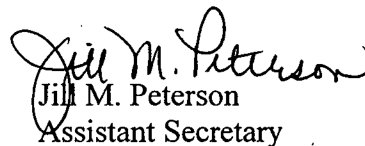
June 5, 2014

In the Matter of FLM Minerals, 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 FLM Minerals, Inc. because it has not filed any periodic reports since the period ended August 31, 2011.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on June 5, 2014, through 11:59 p.m. EDT on June 18, 2014.

By the Commission.



Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 5, 2014

In the Matter of WebXU, 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 WebXU, Inc. because of questions regarding the accuracy of publicly available information about the company's finances.

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 June 5, 2014, through 11:59 p.m. EDT on June 18, 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. 72318 / June 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15908

In the Matter of **China Digital Animation Development, Inc.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT [1]

1. China Digital Animation Development, Inc. ("CHDA") (CIK No. 928835) is a New York corporation located in Xiangfang District, Harbin, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CHDA 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, 2012, which reported a net loss of $7,340,757 for the prior nine months. As of May 28, 2014, the common stock of CHDA was quoted on OTC Link (formerly "Pink Sheets") 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).

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

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

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

which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 5, 2014

In the Matter of **China Digital Animation Development, 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 China Digital Animation Development, Inc. because it has not filed any periodic reports since the period ended March 31, 2012.

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

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. 72322 / June 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15910

In the Matter of

China Power Technology, Inc.,

Respondent.

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

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT [1]

1. China Power Technology, Inc. ("CNPI") (CIK No. 1448500) is a revoked Nevada corporation located in Kaifeng City, Henan Province, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CNPI 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. As of May 28, 2014, the common stock of CNPI was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

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

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

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

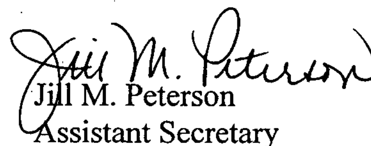
which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.



Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

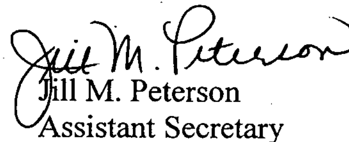
June 5, 2014

In the Matter of China Power Technology, Inc., File No. 500-1	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of China Power Technology, Inc. because it has not filed any periodic reports since the period ended March 31, 2011.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on June 5, 2014, through 11:59 p.m. EDT on June 18, 2014.

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. 72320 / June 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15909

In the Matter of Zhidali Radio and Television Network, Inc., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT [1]

1. Zhidali Radio and Television Network, Inc. ("ZDLA") (CIK No. 1346352) is a delinquent Colorado corporation located in Tengzhou, Shandong, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ZDLA 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 $8,467 for the prior three months. As of May 28, 2014, the common stock of ZDLA was quoted on OTC Link (formerly "Pink Sheets") 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).

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

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

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

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

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

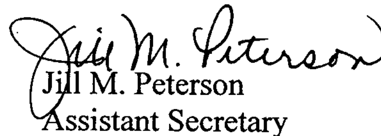
which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.



Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 5, 2014

In the Matter of Zhidali Radio and Television Network, 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 Zhidali Radio and Television Network, Inc. because it has not filed any periodic reports since the period ended December 31, 2010.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed 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 June 5, 2014, through 11:59 p.m. EDT on June 18, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72335 / June 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15911

In the Matter of

BRIAN R. REISS, Esq.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these

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

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any attorney . . . who has been by name (A) [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder; or (B) [f]ound by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party . . . to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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

III.

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

1. Reiss, age 60, is a California resident living in Huntington Beach, California. Reiss is a member of the California State Bar. Reiss provided advice to individuals and entities regarding compliance with the federal securities laws. Reiss has never held any securities licenses and is not registered with the Commission in any capacity.

2. On March 7, 2013, the Commission filed a complaint against Reiss in SEC v. Brian R. Reiss (Civil Action No.1537), in the United States District Court for the Southern District of New York. On March 14, 2014, the court entered an order permanently enjoining Reiss by consent, from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

3. The Commission's complaint alleged, among other things, that Reiss drafted and executed legal opinion letters which caused the transfer agents to remove restrictive legends on stock certificates representing shares of publicly traded companies. Reiss repeatedly drafted and executed opinion letters containing inaccurate statements without making a reasonable inquiry into the underlying facts. The false and misleading statements Reiss made in the legal opinion letters he drafted and executed induced the transfer agents for public companies to remove the restrictive legends and permit the sale of shares to the public. Reiss provided the legal opinion letters to transfer agents who required assurances, in the form of legal opinion letters, that the transactions qualified for an exemption from the registration requirements under the federal securities laws. With this assurance, the transfer agents issued stock certificates without restrictive legends allowing the stock to be traded freely, known as "free-trading" stock. Reiss knew, or was reckless in not knowing, that the shareholders seeking his opinion letters intended to sell the stock on the public markets and that the transfer agents would rely on his opinion letters to issue stock certificates without restrictive legends.

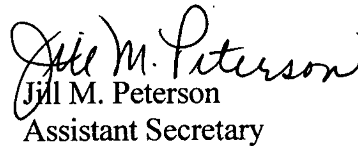
IV.

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

Accordingly, it is hereby ORDERED effective immediately, that:

A. Reiss is suspended from appearing or practicing before the Commission as an attorney.

By the Commission.



Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 6, 2014

IN THE MATTER OF **Prospect Ventures, 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 Prospect Ventures, Inc. ("Prospect") because of questions regarding the accuracy of assertions by Prospect to investors in public filings concerning, among other things, the company's beneficial ownership, assets, and operations. Prospect is a Nevada corporation based in Medellin, Colombia. Prospect's securities are quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc., under the symbol IVAP.

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 June 6, 2014 through 11:59 p.m. EDT on June 19, 2014.

By the Commission.

Jill M. Peterson
Jill M. Peterson
Assistant Secretary

4. Part of an ATS's compliance with Rule 301(b)(10) includes implementing adequate safeguards and procedures to protect the confidential trading information of its subscribers. These procedures must take into account the nature and structure of the interconnected businesses of the broker-dealer operating the ATS. A broker-dealer that operates an ATS may have business units separate from the ATS, but within the same legal entity or separately incorporated affiliates, that, if given access to the confidential trading information of the ATS's subscribers, could benefit from such information. This structure presents risk of misuse of subscriber information, and accordingly, the Commission highlighted the importance that ATSs "separate alternative trading system functions from other broker-dealer functions." Id.

5. Large institutional investors, such as mutual funds, often seek to keep their trading intentions secret, as information leakage can cause unfavorable price movements and thus be costly. For example, if a mutual fund intends to buy a large quantity of a particular stock, and information about the mutual fund's intentions leaks out to the market, opportunistic traders may start buying that stock, with the view to capitalizing on the upward price movement that the mutual fund's large buy order could create. These opportunistic traders' activity, in turn, may cause a short-term price increase, and thus lead the mutual fund to pay more for the stock than the mutual fund would have paid had its trading intentions remained secret.

6. In contrast to the so-called "lit" or "displayed" markets, such as exchanges, dark pools do not display orders residing in them.[3] Because of this feature, traders often turn to dark pools to minimize information leakage and the resulting costs.

7. Liquidnet, which launched its ATS in 2001, operates an institutional trading network for large institutional investors seeking to execute their trades in size, with maximum anonymity and minimum information leakage. Outside the ATS, Liquidnet acts solely as an agency broker and does not engage in proprietary trading activities; nor does it have any affiliates that engage in proprietary trading.

8. A key feature of Liquidnet's relationship with its ATS subscribers, referred to at Liquidnet as "members," is Liquidnet's electronic access to a member's order management system ("OMS"). Liquidnet's ATS system accesses a member's OMS to obtain information about the member's confidential trading intentions ("indications of interest" or "indications") and then uses that information to look for execution opportunities, or "matches," among members interested in buying and selling the same stock. If a match of indications is detected, the potential buyer and seller are invited to negotiate with each other, anonymously, through the Liquidnet system. In the course of the negotiation, the members' indications may become binding orders to buy or sell the stock. An execution occurs when the buyer and the seller agree on the transaction terms – that is,

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[3] Most, but not all, ATSs that trade NMS stocks are dark pools. A smaller subset of ATSs, called electronic communications networks ("ECNs"), do display some of the orders in NMS stocks residing in them. An NMS stock, under Regulation NMS, is a stock "for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan." 17 C.F.R. § 242.600(b)(46).

price and quantity. Throughout this process, the Liquidnet system keeps each member's identity secret from the potential counterparty, and only reveals to the potential counterparty the information that is necessary for achieving an execution.

9. In 2009, in an effort to find additional sources of liquidity for its ATS, Liquidnet began offering its services to corporate issuers and control persons of corporate issuers, as well as to PE/VC firms looking to execute large equity capital markets transactions with minimal market impact. Liquidnet hoped to convince these entities to trade with members in its ATS, in part, by educating them about the block opportunities available within Liquidnet by providing them with confidential information about Liquidnet members' indications and executions. The initiative – which initially included equity research and corporate access services – eventually developed into a stand-alone, small business unit called Equity Capital Markets ("ECM").[4]

10. From the ECM initiative's launch in 2009 and through late 2011, Liquidnet allowed ECM employees to access Liquidnet members' confidential trading information. Because ECM employees neither operated the Liquidnet ATS nor were responsible for its compliance functions, their access to the confidential trading information of ATS subscribers violated the specific requirements of Regulation ATS.

11. In addition, in marketing ECM's services to potential customers, ECM employees used member data in ways that were not disclosed to Liquidnet members and that contradicted Liquidnet's assurances to members that Liquidnet would keep their trading information confidential. For example, some ECM marketing presentations for corporate issuers included descriptive characteristics of members that had recently indicated interest in buying or selling the issuers' stocks. These descriptive characteristics included information about the members' geographic locations, approximate assets under management, and investment styles. ECM employees also contacted issuers to discuss recent trends in the issuers' stocks, and, similar to the marketing presentations, these ad-hoc reports sometimes included member descriptive characteristics, such as geographic regions and investment styles. These external communication practices were inconsistent with Liquidnet's statements to members that Liquidnet would preserve the confidentiality of its members' trading information.

12. In addition, Liquidnet used confidential information about members' indications in two sales tools, in a manner that was not disclosed to Liquidnet members. First, from February 2010 through August 2012, Liquidnet generated alerts, called Ships Passing alerts, about missed execution opportunities between member algorithmic orders and member indications, and distributed these alerts to sales relationship managers ("RMs"). Liquidnet never disclosed to members either that the Ships Passing alerts existed or that RMs could view members' unmatched indications in connection with these alerts. Second, for a brief time in early 2012, Liquidnet RMs used an application called Aqualytics to identify members to contact about Liquidnet's recent dominance in certain stocks. In describing this application to members, Liquidnet initially failed to disclose that an RM's decision to contact a member about Liquidnet's activity in a particular stock

[4] During the relevant time (i.e., from the launch of the ECM initiative in 2009 through the end of November 2011), ECM's gross revenue (in total, approximately $1.66 million) accounted for less than one percent of Liquidnet's total U.S. revenue.

may have been based, in part, on that member's past and current indications of interest for the stock.

Respondent

13. **Liquidnet**, a Delaware corporation with a principal place of business in New York, New York, is a broker-dealer registered with the Commission and operates two ATSs pursuant to Regulation ATS promulgated under the Exchange Act: Negotiation ATS, Liquidnet's primary product (also referred to herein as the "Liquidnet ATS"), and H2O ATS. The Negotiation ATS provides Liquidnet members with anonymous negotiation functionality, whereas the H2O ATS provides members with auto-execution functionalities, including algorithmic order executions.

Background

A. The Liquidnet ATS and Liquidnet's Assurances of Confidentiality

14. Liquidnet's core business is operating a block-trading ATS, or "dark pool," for members who are primarily large institutional investors.

15. A key feature of the Liquidnet ATS is the so-called "blotter-scraping" functionality. A member grants the system electronic access to the member's OMS. The OMS contains real-time information about the member's unexecuted trading intentions – that is, what stocks the member is planning to buy or sell, in what quantities, and at what prices. When the Liquidnet system detects a potential match between two members' "buy" and "sell" intentions, the system alerts the members to the potential match and invites the members to begin an anonymous negotiation through the Liquidnet interface. An execution occurs when the negotiating members agree on trade terms. During the negotiation process, each negotiating member remains anonymous, and information is shared only to the extent necessary for the negotiation process.

16. Anonymity and minimal information leakage are features that attract mutual funds and other large institutional investors to Liquidnet. A large institutional investor may be concerned that, if information about its trading intentions leaks out to the market, opportunistic traders may try to trade ahead of the institution, in order to take advantage of the expected price movement that a large institutional order often creates. Such opportunistic activity, in turn, may itself create a short-term price movement and thus lead the institution to trade at a less favorable price than it would have traded at, had the information about its trading intentions remained secret.

17. At all relevant times, Liquidnet held itself out to members as a trading venue that offers anonymity and minimal information leakage. For example, in its marketing brochures, Liquidnet stated that it directly links buy-side traders with each other while "keeping information leakage to a minimum."

18. Liquidnet also provided members with a description of its system and operations through "Liquidnet Trading Rules," which were incorporated by reference in Liquidnet's subscription agreements with members and were available to members through the Liquidnet website. The Trading Rules assured members that the Liquidnet system would maintain "complete

anonymity of every member and trader in the System during the entire lifecycle of an indication and order."

19. In addition to its negotiation functionality, Liquidnet also offers a suite of algorithmic trading strategies and operates an agency-only trading desk, which executes orders submitted to that desk by Liquidnet members or trading desk customers who are not ATS members. The trading desk's relationship with its customers is more akin to the traditional broker-customer relationship: customers transmit orders to the trading desk employees, and the trading desk executes those orders on the customers' behalf.

B. ECM Group and Its Marketing Strategy

20. In 2009, in an effort to find additional sources of liquidity for the Liquidnet ATS, Liquidnet launched its ECM initiative, which later developed into a small, stand-alone ECM business unit. The goal of the initiative was to introduce Liquidnet as an execution venue for corporate issuers, control persons of corporate issuers, and PE/VC firms. In Liquidnet's view, these potential ECM customers were similar to Liquidnet's ATS customers, because, like those large institutional investors, the potential ECM customers generally had long-term, large-scale trading intentions; did not engage in opportunistic short-term trading; and sought to execute large transactions with minimal information leakage.

21. Members of the Liquidnet executive team participated in the development of the ECM initiative and of the ECM marketing strategy described below, including by participating in the drafting and review of ECM strategy documents and by attending internal leadership meetings during which the executive team discussed updates on the ECM initiative and the internal tools described in paragraph 24.

22. To attract this new group of potential customers, Liquidnet determined to leverage Liquidnet's access to and visibility into members' trading intentions. Specifically, in marketing its ECM business, Liquidnet emphasized that its ECM customers would be able to execute their transactions in scale, with minimal information leakage, and with the benefit of Liquidnet's insight as to the optimal time to access the market. For example, if a corporate issuer was seeking to execute a share repurchase program (a so-called "corporate buy-back"), Liquidnet could advise the issuer when there was substantial supply of the issuer's shares in the Liquidnet system, without substantial competing demand from its members. Conversely, if the issuer was seeking to sell its stock, for example, as part of a registered follow-on offering, Liquidnet could advise the issuer when there was significant demand for the stock, without substantial competing supply from its members.

23. As part of this marketing strategy, in 2009, Liquidnet launched a desk-top application for issuers called InfraRed. InfraRed, which was offered for free to senior executives of corporate issuers, displayed, in line chart form, aggregated historical institutional demand data in the Liquidnet system as a smoothed ratio of "buy" liquidity to "sell" liquidity, capped at 5:1 (or 1:5). For example, if, over a particular time period, all Liquidnet members, in aggregate, were interested in buying three million shares of an issuer's stock, and also were interested in selling one million shares of the stock, InfraRed would depict this information as the "institutional demand"

ratio of 3:1. Because the InfraRed ratio was capped, however, if the "buy" interest increased to six million shares, while the "sell" interest remained the same, at one million shares, the "institutional demand" depicted through InfraRed would reach 5:1 and stay flat at that level. Liquidnet believed that InfraRed could serve as its "calling card" with issuers, reminding issuers about Liquidnet's ability to access institutional liquidity and to advise issuers on market conditions.

C. ECM Employees' Access to Members' Confidential Trading Information

24. From the launch of the ECM initiative in 2009 and through late 2011, ECM employees had access to confidential member trading information residing in the Liquidnet system. For example, ECM employees could generate detailed reports about Liquidnet members' "buy" and "sell" indications for various stocks. In addition, starting in early 2011, ECM employees could view detailed information about members' indications through an internal version of the InfraRed application ("Internal InfraRed"). Information available to ECM employees through the detailed reports and Internal InfraRed included the identity of each Liquidnet member who indicated interest to buy or sell a particular stock, as well as the number of shares that each member was interested in buying or selling.

25. Regulation ATS promulgated under the Exchange Act governs the operations of ATSs such as the Liquidnet ATS. Rule 301(b)(10) of Regulation ATS requires that an ATS "establish adequate safeguards and procedures to protect subscribers' confidential trading information," including "[l]imiting access to the confidential trading information of subscribers to those employees of the [ATS] who are operating the system or responsible for its compliance with [Regulation ATS] or any other applicable rules."

26. Liquidnet's ECM employees neither operated the Liquidnet ATS nor were responsible for the Liquidnet ATS's compliance with the applicable rules and regulations. Instead, ECM employees were tasked with marketing Liquidnet's block-execution abilities to corporate issuers, issuer control persons and PE/VC firms, and with serving as relationship managers for this group of customers. Moreover, ECM customers were not Liquidnet ATS subscribers, or members, and their transactions were executed solely through Liquidnet's trading desk. Thus, by giving ECM employees access to Liquidnet members' confidential trading information, the Liquidnet ATS violated Rule 301(b)(10) of Regulation ATS.

D. ECM Employees' Use of Members' Confidential Trading Information

27. In the very early stages of the ECM initiative, Liquidnet employees discussed Liquidnet's general plan to offer ECM services and InfraRed during member conferences and in one-on-one meetings with some members.

28. Liquidnet also publicly announced the launch of InfraRed for issuers in 2009, and, upon request, Liquidnet representatives demonstrated and explained the InfraRed application to members. These descriptions and demonstrations, however, only focused on the issuer-facing version of InfraRed, described in detail in paragraph 23 above, which displayed aggregate institutional demand information as a smoothed and capped ratio of "buy" and "sell" liquidity. These descriptions and demonstrations did not focus on Internal InfraRed that became available to

ECM employees in early 2011. As described in paragraph 24 above, Internal InfraRed displayed much more detailed and sensitive information, such as member identities and detailed member- and symbol-specific indication information.

29. In addition, by 2010, the ECM group's practices evolved to include uses of confidential member trading information that were not disclosed to Liquidnet members.

30. In particular, some ECM marketing presentations for issuers included charts listing certain descriptive characteristics of those Liquidnet members that recently had either "buy" or "sell" indications for the issuers' stocks. For example, a marketing presentation delivered to an issuer on February 28, 2011, stated that, since January 1, 2011, thirty-two Liquidnet members had either "buy" or "sell" indications for the issuer's stock. This summary statement was followed by a chart, listing, for each of the thirteen "buy" investors and each of the nineteen "sell" investors, a range representing the investor's equity assets under management (e.g., 10-25 billion, 50-100 billion, 100+ billion); geographic location (such as Northeast, Midwest, West, foreign, etc.); investment style (such as value, deep value, index, etc.); and whether the investor was the issuer's "13F holder" (i.e., reported the issuer's stock in its quarterly portfolio report filed on SEC Form 13F[5]).

31. As part of their marketing efforts, ECM employees also frequently reached out to issuers with ad-hoc reports about recent activity in the issuers' stocks, and some of these reports included descriptive characteristics of the members whose information was discussed. For example, on April 26, 2011, an ECM employee contacted an issuer with an update about two block executions on Liquidnet ATS in the issuer's stock that very morning. The ECM employee included the time, quantity and price of each of the two trades; informed the issuer that both trades involved the same seller; and noted that neither the seller nor one of the two buyers involved in the trades were among the issuer's 13F holders, but the second buyer was one of the issuer's 13F holders. The ECM employee further informed the issuer that the "seller still has considerable quantity on the books to offload" and that "[o]ne of the buyers has some residual interest to buy today."

32. Later on that same day, April 26, 2011, upon the issuer's request for additional information, the ECM employee informed the issuer that Liquidnet "did see another new seller come in around noon today, and they're [sic] total sell [quantity] is approximately equal to your ADV [i.e., average daily volume]. They are an existing 13F holder, GARP [Growth At A Reasonable Price] style." Referring to the earlier communication, the ECM employee stated that the "seller I mentioned earlier has approximately 30% of your ADV left to sell (not a 13F holder)" and that "[b]uy interest has remained relatively constant today."

33. In another instance, on August 29, 2011, another ECM employee contacted another issuer with an update that "Liquidnet was extremely active in [the issuer's] shares at the end of last week. We crossed nearly 1 million shares, principally between a single buyer and seller. The

[5] SEC Form 13F is a form on which large institutional investment managers report their portfolio holdings of certain securities. SEC Forms 13F are filed on a quarterly basis and are publicly available through the Commission's EDGAR database.

buyer is a top-20 holder who reported a reduced position at the June 30th 13-F filings. The seller is a hedge fund."

34. In addition, ECM marketing presentations for issuers often included information about aggregate "liquidity depth" in a stock over a period of time, expressed in absolute dollar terms rather than as the smoothed and capped ratio that issuers saw through InfraRed. For example, a marketing presentation delivered to an issuer could include a chart showing the magnitude of aggregate "buy" and "sell" interest, expressed in total dollar terms, for the issuer's stock in Liquidnet's system on each day during the past few weeks.

35. ECM employees also sometimes provided issuers with feedback on lists of institutional investors with which issuers met or were planning to meet during non-deal roadshows or investor conferences. Sometimes, ECM employees would recommend to issuers specific investors with whom issuers should meet based on those investors' recent "activity" or "interest" either in the issuer's stock or in the stock of the issuer's industry peers. On other occasions, ECM employees would provide issuers information regarding how many of the firms on the issuer's meeting or conference list were Liquidnet members and, of those, how many had had "buy" or "sell" interest in the issuer's stock.

36. For example, on May 17, 2011, an ECM employee, in response to an inquiry from an issuer's investor relations officer preparing for a set of investor meetings, provided the following feedback:

> - Of the 11 firms you're meeting with, 7 are Liquidnet members
> - Three of the firms you're meeting with have shown overall net buy interest in your stock YTD
> - One of the firms you're meeting with has shown an overall net sell interest in your stock YTD.

37. When an ECM customer signed on to execute transactions through Liquidnet, ECM employees used members' trading information to advise the ECM customer when to submit an order to the Liquidnet system. For example, ECM employees used member data to determine whether a particular day was a good day for an issuer to submit an order as part of the issuer's buy-back program – that is, whether there was sufficient supply of the issuer's shares in Liquidnet's system, and whether there was much competing demand from members for those shares.

38. ECM employees also sometimes used both current and historical member trading information to identify those members who would likely be interested in trading with an ECM customer. For example, if an ECM employee working on an issuer buy-back program saw that a particular member recently had "sell" indications for the issuer's stock (but no current indications), the ECM employee would sometimes contact the RM covering that member and suggest that the RM contact the member and open a discussion about the member's current interest in selling the stock.

39. Liquidnet's general written policies, not specific to the ECM group, prohibited any sharing of confidential member information, internally or externally, except as required in connection with an employee's performance of his or her job responsibilities. Liquidnet failed to provide ECM employees with specific guidance, however, on how this general prohibition applied to the ECM employees' internal and external communications.

40. ECM employees developed among themselves an informal and unwritten guideline focused on protecting member anonymity. ECM employees generally adhered to the view that, in their external communication, they should not disclose either a member's identity or such information as would enable an outside person to deduce a member's identity. Consistent with this informal guideline, on multiple occasions, when issuers requested information about member identities, ECM employees declined to provide it. The ECM employees' informal guideline, however, was premised on an unduly narrow view of Liquidnet's confidentiality obligations, which required, more broadly, that Liquidnet protect its subscribers' confidential trading information – and not solely the subscribers' identity information.

E. Liquidnet's Material Omissions About ECM and ECM Practices

41. While the ECM group engaged in the practices described in Part D above, Liquidnet continued to assure its members that Liquidnet was protecting the confidentiality of their trading information. In Liquidnet's subscription agreements, Trading Rules, and marketing materials, Liquidnet stated that Liquidnet would preserve the anonymity of member indications and orders and would minimize information leakage.

42. For example, in its Trading Rules, Liquidnet stated that its "System maintains complete anonymity of every member and trader in the System during the entire lifecycle of an indication and order." Liquidnet also described how an indication or an order would interact with the Liquidnet system, and to what extent information about an indication or an order would be revealed to a potential counterparty as part of the anonymous negotiation or auto-execution process.

43. Further in the Trading Rules, Liquidnet described InfraRed as "a product that aggregates institutional sentiment, supply and demand, news sentiment, and block execution data for investor relations officers and CFOs on their stock," and that provides "all Liquidnet data ... on an aggregated basis."

44. In addition, Liquidnet informed its members, in the Trading Rules, that it had "established and implemented policies to maintain the segregation of sales, trading desk and member services functions," and provided brief descriptions of member trading information available to Liquidnet's sales, trading desk and member services personnel. For example, the Trading Rules stated that Trading Desk personnel could not view member indications, whereas sales RMs could view both members' algorithmic orders and members' matching indications, and that the RMs could contact members to facilitate negotiations.

45. The Trading Rules did not disclose, however, either the existence of the ECM group; or the fact that ECM employees had access to detailed and confidential member trading

information; or the fact that the ECM group used that information to engage in the practices described in detail in Part D above.

46. The omissions described above made Liquidnet's representations to members materially misleading. As noted above, Liquidnet members were concerned about information leakage and confidentiality of their trading information. Liquidnet's assurances of confidentiality and anonymity were particularly material to Liquidnet's members because the members relied on those assurances in providing the Liquidnet system with access to the members' highly sensitive, real-time indication information.

47. Liquidnet disclosed the existence of the ECM group in the July 2011 version of the Trading Rules and referenced the existence of the ECM group in certain corporate press releases issued before that time. But the ECM group's access to and use of confidential member information remained undisclosed until December 2011, when Liquidnet first informed its members that "ECM personnel can view summary buy/sell demand information from individual Members on a symbol-by-symbol basis." This disclosure followed an inspection of Liquidnet by the staff of the Commission's Office of Compliance Inspections and Examinations, during which Commission staff raised concerns about the ECM group's access to and use of member trading information.

F. Liquidnet's Failure to Update Form ATS Filings

48. Rule 301(b)(2) of Regulation ATS requires an ATS to file an amendment on Form ATS at least 20 days prior to implementing a material change to the operation of the ATS, 30 days after the end of a quarter when information contained in an initial operation report filed on Form ATS becomes inaccurate, and promptly upon discovering that an initial operation report filed on Form ATS or an amendment on Form ATS was inaccurate when filed. 17 C.F.R. § 242.301(b)(2).

49. As part of its Form ATS filing obligations, Liquidnet filed with the Commission its Trading Rules. As set forth in greater detail in Part E above, at certain relevant times, Liquidnet's Trading Rules provided assurances of confidentiality and anonymity and descriptions of Liquidnet's operations, policies and procedures, but failed to disclose at all relevant times the existence of the ECM group, the ECM group's access to the confidential trading information of Liquidnet ATS members, or the ECM group's uses of that information. These were material changes to the operation of the Liquidnet ATS, for which the Liquidnet ATS was required to file an amendment on Form ATS at least 20 days prior to implementation. By failing to update its filings to include this information, Liquidnet violated the requirements of Rule 301(b)(2).

G. Failure to Properly Implement InfraRed Opt-Outs

50. When Liquidnet launched InfraRed in 2009, approximately nineteen members requested to opt out from InfraRed – in other words, not to include their trading information in the InfraRed application. Liquidnet assured these members that they were opted out and excluded these members' trading data from the external InfraRed application that was offered to issuers.

51. But, from the launch of the ECM initiative in 2009 and at least until November 2011, Liquidnet failed to exclude the "opted out" members' trading information from any of the internal reports and tools that the ECM group generated and used.[6] Thus, apart from the external InfraRed application provided to issuers, these members' trading information was used in the same manner as all the other members' information. For example, ECM employees described the "opted out" members' indications, executions, and descriptive characteristics in marketing materials and ad hoc reports to issuers, as well as in providing feedback to issuers on potential non-deal roadshow or conference meeting schedules.

H. Ships Passing Alerts and Aqualytics

52. Liquidnet improperly used its members' confidential trading information in generating and circulating Ships Passing alerts to employees, as well as in targeting members for marketing communications through an application called Aqualytics.

a. Ships Passing Alerts

53. Ships Passing alerts were initially implemented in 2009 as notifications to Liquidnet RMs that two members' algorithmic orders were failing to match and execute because their limit prices failed to overlap. Liquidnet established a written protocol for the RMs' contacts with members, which required that the RMs maintain the anonymity of both members involved (that is, of both the potential buyer and the potential seller). The RMs were also required to obtain member consent before discussing the member's information with a potential contra-party.

54. In February 2010, Liquidnet expanded the Ships Passing alerts to include notifications of situations where a member's algorithmic order failed to match with a member's indication. The failure to match could be caused by a number of scenarios, including different limit prices or mismatches in the sizes of the buy and sell orders.

55. The Liquidnet Trading Rules referenced the fact that RMs could view members' algorithmic orders and members' matching, unexecuted indications, and that RMs could contact members to facilitate negotiations.

56. The Ships Passing alerts, however, displayed to RMs not only member algorithmic orders and member matching indications but also unmatched indications. Thus, Liquidnet's use of member data in the Ships Passing alerts was inconsistent with the Trading Rules disclosure.

57. In addition, from at least late 2010, in distributing the Ships Passing alerts, Liquidnet failed to exclude Trading Desk personnel from the email distribution list. Thus, even though the alerts were only intended for the ATS RMs, for a time, Trading Desk employees received them as well.

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[6] Liquidnet also failed to exclude the affiliates of four of the "opted out" members from the external InfraRed application until November 2011, due to an error in mapping member identifications in the course of a technical upgrade.

58. Liquidnet discontinued the Ships Passing alerts in August 2012.

b. Aqualytics

59. In February 2012, Liquidnet rolled out an internal application for RMs called Aqualytics. Aqualytics notified RMs about significant "stories" in particular securities, such as Liquidnet's recent dominance in executions in a particular stock, or a recent block execution in a stock. Each story sent to an RM was accompanied by a list of "targets" – that is, members within that RM's sales coverage to contact about the story, followed by a brief list of reasons why that particular target was identified.

60. The Aqualytics targeting feature was based on members' publicly available 13F filings and on their confidential execution and indications data. For example, Aqualytics could alert an RM to a recent large Liquidnet execution in a particular stock and also suggest that the RM share this story with a "target" member because that member (1) reported a large position in that stock in a recent Form 13F; (2) had no intraday indications for that stock; and (3) had a sell indication for a specified quantity of that stock a few days earlier.

61. The purpose of the Aqualytics alerts was to encourage members to create new indications, by highlighting Liquidnet's expertise in obtaining block executions for the specific stocks that may be of interest to a particular member.

62. On March 9, 2012, Liquidnet disclosed the existence of Aqualytics in its Trading Rules, as follows:

> With this support tool, our RMs receive notification of US stocks where Liquidnet has recently executed a significant percentage of ADV. The report identifies Members with 13F holdings in these stocks and Members that have recently executed in these stocks through Liquidnet, so the RM can notify the Member of Liquidnet's activity in these names. The objective is to provide Members additional opportunities to interact in stocks where Liquidnet has been successful in matching large blocks. A member can opt out of this functionality by contacting its RM.

Liquidnet did not disclose, however, that members may have been targeted for Aqualytics alerts, in part, based on their past or current indications.

63. On May 1, 2012, Liquidnet amended its Trading Rules section on Aqualytics, adding the statement that "[i]n identifying members, the [Aqualytics] report may also include limited member indication information for the relevant stock." Liquidnet discontinued Aqualytics in June 2012.

Violations

64. As a result of the conduct described above, Liquidnet willfully[7] violated:

a. Section 17(a)(2) of the Securities Act, which prohibits, directly or indirectly, in the offer or sale of securities, obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;

b. Rule 301(b)(2) of Regulation ATS, which requires an ATS to file an amendment on Form ATS at least 20 days prior to implementing a material change to the operation of the ATS, within 30 days after the end of a quarter when information contained in an initial operation report filed on Form ATS becomes inaccurate, and promptly upon discovering that an initial operation report filed on Form ATS or an amendment on Form ATS was inaccurate when filed; and

c. Rule 301(b)(10) of Regulation ATS, which requires an ATS to establish adequate safeguards and procedures to protect subscribers' confidential trading information and to adopt and implement adequate oversight procedures to ensure that the safeguards and procedures for protecting subscribers' confidential trading information are followed.

Liquidnet's Remedial Efforts

65. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Liquidnet, including the development of a program that provides members with direct control over use of their data within the Liquidnet system.

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[7] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Liquidnet cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Rules 301(b)(2) and 301(b)(10) of Regulation ATS promulgated under the Exchange Act.

B. Liquidnet is censured.

C. Liquidnet shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $2,000,000.00 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 Liquidnet 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 Amelia Cottrell, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

By the Commission.

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72341 / June 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15914

In the Matter of Symbollon Pharmaceuticals, Inc., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Respondent Symbollon Pharmaceuticals, Inc. (f/k/a Symbollon Corporation) ("Symbollon" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. **RESPONDENT**

1. Symbollon (ticker symbol "SYMBA") (CIK No. 0000912086) is an inactive Delaware corporation located in Medfield, Massachusetts with a class of securities registered with the Commission pursuant to Section 12(g) of the Exchange Act. Symbollon securities are traded on the over-the-counter markets. Symbollon purportedly was engaged in the development and commercialization of proprietary iodine-based agents and antimicrobials.

B. **DELINQUENT PERIODIC FILINGS**

2. Symbollon has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since it filed a Form 10-Q for the period ended March 31, 2011 on

May 16, 2011, in which it reported that Symbollon had a net loss of $448,179 and $87,956 and negative cash flows from operations of $228,596 and $44,898 for the year ended December 31, 2010 and three months ended March 31, 2011, respectively. Symbollon also disclosed that, as of March 31, 2011, it had an accumulated deficit of $22,619,618 and negative working capital of $468,999. Further, it reported that it did not have adequate cash resources to continue its base operations.

3. Symbollon is delinquent in its periodic filings with the Commission, having repeatedly failed to meet its obligations to file timely periodic reports. Indeed, Symbollon has failed to file its last twelve required reports: three Forms 10-K and nine Forms 10-Q.

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

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/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 Symbollon 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 Symbollon, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of Symbollon.

IV.

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

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

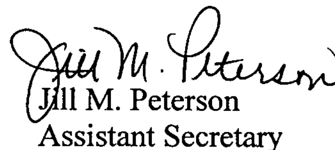
If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against 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 the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.



Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72340 / June 6, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3845 / June 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15913

In the Matter of Wedbush Securities Inc., Jeffrey Bell, and Christina Fillhart, 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 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative 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 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Wedbush Securities Inc. ("Wedbush"), Jeffrey Bell ("Bell"), and Christina Fillhart ("Fillhart") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

Summary

1. These proceedings involve the market access business of Wedbush, one of the largest volume market access providers in the United States. From July 2011 until at least January 2013 (the "relevant period"), Wedbush served as the gateway to U.S. markets for dozens of trading firms, including foreign, domestic, registered, and unregistered firms, as well as thousands of their traders. Most of these firms and their traders engaged in trading activity that did not flow through any Wedbush systems before reaching exchanges and other trading venues in the U.S.

2. During the relevant period, Wedbush failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the risks associated with its market access business, as required by Exchange Act Rule 15c3-5 (the

"Market Access Rule" or "Rule").[1] Violations of the Market Access Rule pose significant risks to the orderly functioning of the U.S. securities markets. Wedbush allowed thousands of essentially anonymous foreign traders to send orders directly to U.S. trading venues to trade billions of shares every month. Wedbush enjoyed increased trading commissions and fees generated by its high-volume market access customers from its risky market access business.

3. As alleged below, Wedbush failed to adopt and implement risk management controls that were reasonably designed to ensure compliance with applicable regulatory requirements—such as those for preventing naked short sales, wash trades, manipulative layering and money laundering. Wedbush's failure to adopt and implement such controls came after communications by the Commission's staff through an examination deficiency letter and in face-to-face meetings regarding Wedbush's compliance procedures whereby the staff informed Wedbush of compliance shortcomings and significant compliance concerns, particularly the access provided to unknown overseas traders. By nonetheless failing to adopt and implement the necessary risk management controls, Wedbush willfully violated the Market Access Rule, while Bell and Fillhart caused Wedbush's violation of the Rule by virtue of their responsibilities at the firm and their participation in communications with the Commission's staff.

4. Wedbush's lack of reasonably-designed market access controls and procedures resulted in Wedbush violating other regulatory requirements, including Regulations SHO and NMS. Wedbush also failed to preserve certain written communications with customers pertaining to its business as required by Exchange Act Rule 17a-4, including communications containing trading instructions relating to brokerage orders submitted directly by Wedbush's market access customers. In connection with its market access business, Wedbush also failed to file suspicious activity reports pursuant to anti-money laundering ("AML") requirements in violation of Exchange Act Rule 17a-8.

Respondents

5. Wedbush Securities Inc. is a California corporation with its headquarters in Los Angeles, California. The firm was founded in 1955 and registered with the Commission as a broker-dealer in 1966 and as an investment adviser in 1970. Wedbush is a wholly-owned subsidiary of Wedbush, Inc., a privately-held company. As of December 31, 2012, Wedbush had 79 branch offices and 844 employees. During the relevant period, Wedbush was consistently ranked as one of the five largest firms by trading volume on NASDAQ.

6. During the relevant period, Jeffrey Bell was Executive Vice President of the Correspondent Services Division of Wedbush, reporting to the firm's President, and was an associated person of Wedbush. Bell also was a member of Wedbush's Board of Directors and President of Lime Brokerage LLC ("Lime"), another wholly-owned subsidiary of Wedbush, Inc. Bell, age 39, is a resident of Hermosa Beach, California, and holds Series 7 and 24 licenses.

7. During the relevant period, Christina Fillhart was a Senior Vice President in the Correspondent Services Division of Wedbush and was an associated person of Wedbush. Fillhart reported to Bell until late 2012, when she began reporting to one of Wedbush's Co-Chief Compliance Officers. Fillhart, age 55, is a resident of Covina, California, and holds Series 7, 24, 27, 53, and 63 licenses.

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[1] 17 C.F.R. § 240.15c3-5.

The Market Access Rule

8. The Commission adopted the Market Access Rule in November 2010 to require that broker-dealers with market access "appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system." *Risk Management Controls for Brokers or Dealers with Market Access*, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (Final Rule Release).

9. Section (b) of the Market Access Rule requires a broker-dealer with market access, or that provides a customer or any other person with access to an exchange through the use of its market participant identifier ("MPID") or otherwise, to "establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks" of its market access business.

10. Section (c) of the Market Access Rule identifies specific required elements of a broker-dealer's system of risk management controls and supervisory procedures relating to market access. Subsection (c)(1) addresses financial controls and procedures and subsection (c)(2) addresses regulatory controls and procedures. Under subsection (c)(2), a broker-dealer must have controls and procedures that are reasonably designed to ensure compliance with all regulatory requirements, including controls to prevent the entry of orders that do not comply with all regulatory requirements that must be satisfied on a pre-order entry basis and controls to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker-dealer with market access.

11. Section (d) of the Market Access Rule requires the risk management controls and supervisory procedures to be under the "direct and exclusive control" of the broker-dealer with market access. Subsection (d)(1) contains an exception to the direct and exclusive control requirement that applies when a broker-dealer with market access reasonably allocates, by written contract, after a thorough due diligence review, control over specific regulatory risk management controls and supervisory procedures to a broker-dealer customer who is registered with an exchange in the United States where the broker or dealer with market access has a reasonable basis for determining that such broker-dealer customer, based on its position in the transaction and relationship with an ultimate customer, has better access to the ultimate customer and its trading information such that it can more effectively implement the specified controls or procedures.

12. Section (e) of the Market Access Rule requires a broker-dealer with market access to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access. Subsection (e)(1) requires the broker-dealer to conduct and document a review of its market access business at least annually in accordance with written procedures, and subsection (e)(2) requires the CEO to certify annually that the broker-dealer conducted the review and is in compliance with the Rule.

Wedbush's Market Access Business

13. The market access business at Wedbush is part of the Correspondent Services Division, which originally handled only traditional clearing operations for introducing broker-dealers, otherwise known as "correspondent" firms. Wedbush began providing "sponsored" market access to customer firms in 2004, which allowed customer firms and their traders to send orders that

bypassed Wedbush's trading systems and were routed directly to exchanges and other trading venues under a Wedbush MPID. Sponsored access customers were able to send orders that bypassed Wedbush's systems by using online trading platforms or software programs that the customer either owned directly or leased from a third-party platform provider, referred to as a service bureau.

14. During the relevant period, Wedbush had about 50 sponsored access customers that generated average monthly trading volume of 30 billion shares. Several of Wedbush's sponsored access customer firms had more than 1,000 authorized traders each, and one had more than 10,000 traders. Wedbush's correspondent services business was the most profitable operation of Wedbush, Inc. Bell and Fillhart each received bonus compensation based on the profitability of the Correspondent Services Division, which depended largely on the trading volumes of Wedbush's market access customers. During the relevant period, Bell received salary of $344,000 and bonus compensation of $310,000 and Fillhart received salary of $150,000 and bonus compensation of $105,000.

15. In June 2011, Wedbush acquired Lime Brokerage LLC, a provider of trading technology platforms. After Wedbush acquired Lime, about 20% of Wedbush's sponsored access customers began using the Lime platform. The other 80% continued to use sponsored access either through their own proprietary trading platform or through a third-party platform that the customer leased from a service bureau. As a result, during the relevant period, the vast majority of orders from Wedbush's sponsored access customers did not flow through Wedbush's own risk management systems.

16. Wedbush's primary risk management controls and supervisory procedures relating to market access were described in Chapter 31 of the firm's written supervisory procedures ("WSPs"), titled "Sponsored Access." On July 14, 2011, the day most provisions of the Market Access Rule took effect, Wedbush updated Chapter 31 to cite certain provisions of the Rule.

17. Bell and Fillhart, along with one other senior Wedbush employee in the Correspondent Services Division, had the primary responsibility for preparing and adopting Wedbush's controls and procedures relating to market access. Bell and Fillhart had authority to adopt and revise the firm's controls and procedures relating to market access, including the WSPs, without approval of Wedbush's President or Co-Chief Compliance Officers.

Wedbush Knew Of Compliance Issues For Its Sponsored Access Trading

18. Prior to the effective date of Rule 15c3-5, Wedbush received a number of indications that its sponsored access trading business posed particular regulatory and compliance risks. In 2009 and 2010, just before the relevant period, two of Wedbush's sponsored access customer firms extended their market access to a Latvian trader who used that access to conduct profitable trading as part of a widespread account intrusion and market manipulation scheme. The Commission obtained a judgment by default against the Latvian trader in connection with the scheme after learning the trader's identity from Fillhart in 2011. *See SEC v. Nagaicevs*, N.D. Cal. Case No. 12-CV-00413-JST (Order Granting Motion for Default Judgment, dated July 12, 2013; Order of Judgment and Equitable and Other Relief Against Defendant Igors Nagaicevs, dated July 18, 2013).

19. The Commission also imposed cease-and-desist orders, civil monetary penalties, and other relief against one of the Wedbush customer firms for acting as an unregistered broker in

extending market access to the Latvian trader, and also obtained relief against the firm's principals. *See In the Matter of KM Capital Management, LLC, et al.*, Admin. Proc. File No. 3-14720 (Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Yisroel M. Wachs, dated Sept. 19, 2012; Initial Decision as to KM Capital Management, LLC and Joshua A. Klein, dated Nov. 28, 2012; Notice that Initial Decision Has Become Final, dated Oct. 17, 2013).

20. Wedbush was well aware of the requirements, objectives, and importance of Rule 15c3-5. During the public comment period for the then-proposed Rule 15c3-5, Bell submitted a comment letter to the Commission on behalf of Wedbush on February 23, 2009. Although proposing certain changes to the proposed Rule, Bell and Wedbush stated that sponsoring non-broker-dealer customers "requires the highest level of due diligence, oversight and controls. In this case, the sponsoring member is also the broker-dealer of record and would be accountable for all the responsibilities as such." Despite this acknowledgement, one of Wedbush's largest sponsored access customers was not a broker-dealer registered in the United States, and Wedbush failed to engage in the "highest level of due diligence, oversight and controls."

21. On May 17, 2011, Commission staff from the Office of Compliance Inspections and Examinations ("OCIE") sent an Examination Deficiency Letter addressed to Bell on behalf of Wedbush. That letter advised Wedbush that the staff had identified deficient Wedbush controls relating to short sales, in violation of Regulation SHO, due in part to an excessive reliance upon a non-broker-dealer sponsored access client to locate shares before placing a short sale order. The Deficiency Letter also identified problems with internal controls over a third-party order management system. The Letter also stated that Wedbush had failed to respond promptly to compliance issues when they arose and there were weaknesses in its anti-money-laundering controls. This letter put Wedbush on notice that it was relying on inadequate regulatory controls that were outside of its direct and exclusive control.

22. On July 5, 2011, Wedbush representatives, including Bell and Fillhart, met with representatives of OCIE to discuss the impending effectiveness of the final Rule 15c3-5. During that meeting, the Commission's staff expressed concerns about Wedbush's largest sponsored non-broker-dealer client and the need to identify the ultimate traders. Wedbush's presentation to the staff cited the Market Access Rule requirements relating to allocating compliance responsibilities to the sponsored access client and maintaining "direct and exclusive control" of risk settings in customer trading platforms.

Market Access Through Third-Party Trading Platforms

23. Section (d) of the Market Access Rule requires Wedbush to maintain exclusive control over the risk settings in the trading platforms that its customers use to access the markets, including both Wedbush's own Lime platform and the non-Wedbush trading platforms that 80% of Wedbush's customers used. As described below, for many customers that used non-Wedbush trading platforms, Wedbush's control was not exclusive because it allowed customers to have access to determine and make changes to risk settings in the trading platforms.

24. Wedbush did not directly set or monitor regulatory risk settings in the third-party or client-proprietary trading platforms that 80% of Wedbush's customers used. Customers had access to set and revise the risk settings, and could disable risk settings intended to prevent violations of specific regulatory requirements, such as illegal short sales, wash trades, and violations of

Regulation NMS. In addition to Wedbush not having exclusive control over the settings, Wedbush's customers, rather than Wedbush, leased the trading platforms from third parties and Wedbush had no contractual relationship with the platform providers.

25. Wedbush employees in the Correspondent Services Division received access from platform providers to view risk settings and trading activity in the platforms, but Bell and Fillhart knew that Wedbush did not have exclusive control over the settings.

26. Shortly before most provisions of the Market Access Rule took effect, Wedbush obtained email statements from many of the trading platform providers that the risk management settings in the platforms were under the direct and exclusive control of Wedbush. In reality, Wedbush did not have exclusive control of the risk management settings because Wedbush continued allowing sponsored access customers to determine and make changes to the risk settings in the platforms, and Wedbush had no contractual relationship with the platform providers. These statements also were not part of any legally enforceable contract; Wedbush had no contractual relationship with the platform providers.

27. Wedbush's WSPs stated that each new sponsored access customer would perform an initial "risk demonstration" to show Wedbush the customer's trading platform settings for certain financial and regulatory risk controls. Wedbush had a checklist for the risk demonstration that included settings to prevent clearly erroneous trades, wash trades, illegal short sales,[2] and, unless authorized by Wedbush, intermarket sweep orders ("ISOs").[3] That Wedbush needed the customer to show the settings to Wedbush demonstrates that Wedbush did not have "direct and exclusive control" over the risk settings in the platforms, as required by Rule 15c3-5(d).

28. In June 2012, platform providers, rather than sponsored access customers, began providing Wedbush initial demonstrations of risk settings in their trading platforms. During a demonstration, the provider would submit test orders and confirm that certain risk settings were in place at the time of the demonstration.

29. Wedbush did not receive demonstrations of the actual risk settings in effect for particular sponsored access customers, and Wedbush did not have any physical ability to prevent customers from subsequently changing the settings shown during the platform provider's initial demonstration. Wedbush also did not maintain records of the risk settings in the platforms so that it could determine whether any settings had been changed without its consent.

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[2] Rule 203(b)(1) of Regulation SHO prohibits broker-dealers from accepting or effecting a short sale order unless the broker-dealer has borrowed the security or entered into an arrangement to borrow the security, or has reasonable grounds to believe that the security can be timely borrowed, and has documented its compliance with Rule 203(b)(1).

[3] Rule 611(c) of Regulation NMS requires the broker-dealer responsible for routing an ISO to take reasonable steps to establish that the order meets the requirements of Rule 600(b)(30) of Regulation NMS, which requires the broker-dealer routing the ISO to route simultaneously additional orders, as necessary, to execute against the full size of all better-priced protected quotations.

30. Customers could, and sometimes did, change the risk settings without Wedbush's knowledge or consent. For example, as discussed below, Fillhart learned that a customer repeatedly disabled a risk setting to prevent wash trades, and that on numerous occasions a risk setting to prevent illegal short sales failed to prevent violations of Regulation SHO because the wrong list of securities that were easy to borrow was loaded into the customer's third-party trading platform. Fillhart also learned that a customer repeatedly circumvented a risk setting that was designed to prevent the use of ISOs.

Attempts to Allocate Responsibility for Regulatory Controls and Procedures

31. The Final Rule Release for the Market Access Rule stated that Section 15c3-5(d) "is designed to eliminate the practice . . . whereby the broker-dealer providing market access relies on its customer, a third party service provider, or others, to establish and maintain the applicable risk controls." *See* 75 Fed. Reg. at 69804. The Final Rule Release further cautioned that "the Commission continues to be concerned about circumstances where broker-dealers providing market access simply rely on assurances from their customers that appropriate risk controls are in place. . . . Accordingly, the Commission emphasizes that in any permitted allocation arrangement, the broker-dealer providing market access may not merely rely on another broker-dealer's attestation that it has implemented appropriate controls or procedures." *Id.* at 69808.

32. After the Market Access Rule took effect, Wedbush simply relied on attestations in the exact manner that the Final Rule Release said was improper. Wedbush attempted to assign to other broker-dealers the responsibility for regulatory risk management controls and supervisory procedures for many of its sponsored access customers. Wedbush employees documented purported agreements to assign responsibilities to other broker-dealers, but as described below, despite the plain language of Rule 15c3-5(d) and the staff's statements on July 5, 2011, Wedbush failed to conduct the required "thorough due diligence review" when purporting to allocate responsibility to another broker-dealer and continued to simply rely on the other broker-dealer's attestation that it had implemented appropriate controls and procedures.

33. For some customers, Wedbush entered into an allocation agreement with a registered introducing broker-dealer. For other customers, Wedbush entered into an allocation agreement directly with the sponsored access customer itself, if it was a registered broker-dealer trading its own capital on a proprietary basis. Some of these sponsored access customers used trading platforms that they themselves owned, either directly or through a corporate affiliate that they controlled. As a result, Wedbush often relied on a broker-dealer customer to monitor its own trading.

34. All of Wedbush's purported allocation agreements were based on the same form, which Bell approved. The agreements did not specify any particular controls or procedures that Wedbush purported to be allocating. Even though Wedbush, as the party with market access, purportedly was attempting to allocate responsibility for controls or procedures to another broker-dealer, the agreements mistakenly stated that the other broker-dealer, rather than Wedbush, had "allocatable regulatory responsibilities as defined within SEC Rule 15c3-5." As a result, it was not even clear from the documents themselves from and to which broker-dealer the controls or procedures purportedly were being allocated.

35. Bell knew that Wedbush did not conduct the required due diligence reviews of the other broker-dealers in connection with its attempts to allocate responsibilities for market access

controls and procedures, and that Wedbush also did not conduct later reviews to determine whether the other broker-dealers were adequately carrying out the responsibilities purportedly allocated. The agreements simply contained a statement by the introducing broker-dealer or registered customer firm that its regulatory risk management controls and supervisory procedures were reasonably designed to ensure compliance with all regulatory requirements.

36. Better access to the ultimate customer was discussed in the Final Rule Release as the reason why control over certain regulatory controls could be allocated after due diligence. Yet Wedbush did not have any policies or procedures for determining whether a broker-dealer to which it claimed to have assigned responsibilities had better access than Wedbush to ultimate customers such that the other broker-dealer could more effectively implement the risk management controls and supervisory procedures relating to market access.

Regulatory Requirements That Must Be Satisfied On a Pre-Order Entry Basis

37. Subsection (c)(2)(i) of the Market Access Rule required Wedbush to have risk management controls and supervisory procedures that were reasonably designed to prevent the entry of orders that do not comply with all regulatory requirements that must be satisfied on a pre-order entry basis. The Final Rule Release for the Market Access Rule specifically identified Regulations SHO and NMS as examples of regulatory requirements that must be satisfied on a pre-order entry basis, and with which a broker-dealer's controls and procedures must ensure compliance. *See* 75 Fed. Reg. at 69803. As described below, Wedbush's risk management controls and supervisory procedures were not reasonably designed to satisfy these pre-trade regulatory requirements and, in fact, did not prevent Wedbush customers from entering numerous orders that violated Regulations SHO and NMS.

38. Wedbush was responsible for ensuring that all short-sale orders submitted by its sponsored access customers complied with Regulation SHO. Among other things, Regulation SHO required Wedbush, prior to accepting or effecting a short sale order, to borrow the security or enter into an agreement to borrow the security, or have reasonable grounds to believe that the security could be timely borrowed (generally known as the "locate" requirement). Absent countervailing factors, "easy-to-borrow" lists may provide "reasonable grounds" for a broker-dealer to believe that the security sold short is available for borrowing without directly contacting the source of the borrowed securities (known as "easy-to-borrow securities"). Thus, for instance, if a broker-dealer seeking to rely on the list knows or should know that there are concerns regarding the list, it would not be reasonable for the broker-dealer to rely on the list. As an example, the Commission has stated that repeated failures to deliver in securities included on an "easy-to-borrow" list would indicate that the broker-dealer's reliance on such a list did not satisfy the "reasonable grounds" standard of Rule 203. *See Short Sales*, 69 Fed. Reg. 48008, 48014 (Aug. 6, 2004).

39. Wedbush's WSPs stated that the firm sometimes relied on sponsored access customers to meet the short-sale requirements of Regulation SHO. Wedbush maintained a list of easy-to-borrow securities, but Wedbush relied on sponsored access customers or their platform providers to load that list into third-party trading platforms rather than taking direct steps to make sure that customers were using the correct list. Maintaining up-to-date lists in the trading platforms was a key step in the control process because the platforms relied on the lists to determine whether Regulation SHO had been satisfied before routing a short-sale order for execution.

40. Wedbush's procedures asserted that Wedbush allowed customers to submit short-sale orders for securities on the easy-to-borrow list and that it required customers to otherwise locate shares to borrow before submitting short-sale orders for securities not on the easy-to-borrow list. However, Wedbush had no controls or procedures to verify that a security for which a customer submitted a short-sale order was in fact easy-to-borrow at the time the customer submitted the order.

41. On three occasions between July 2011 and November 2012, Fillhart learned that a customer or platform provider loaded the wrong easy-to-borrow list, which resulted in Wedbush customers submitting short-sale orders for securities that were not easy to borrow without first otherwise locating shares to borrow as required by Regulation SHO. Bell and Fillhart knew that similar incidents had occurred numerous times before July 2011, based on the May 2011 OCIE Deficiency Letter and face-to-face meetings that Bell and Fillhart attended with Commission staff. The incidents demonstrated that Wedbush did not have "direct and exclusive control" over these risk settings in the trading platforms as required by Rule 15c3-5(d) and did not have controls reasonably designed to ensure compliance with all regulatory requirements that must be satisfied on a pre-order entry basis.

42. Wedbush was responsible for ensuring that all orders marked as ISOs by its sponsored access customers complied with Regulation NMS, which requires the broker-dealer responsible for routing an ISO to route simultaneously additional orders, as necessary, to execute against the full size of all better-priced protected quotations. Sending the simultaneous orders to sweep the market of better-priced protected quotations is essential to ensuring that the ISO order type is not misused and that other market participants willing to trade at more favorable prices do not have their orders bypassed.

43. Wedbush's WSPs asserted that in order to comply with Regulation NMS, Wedbush did not permit a customer to use ISOs unless the customer swept the market of all better-priced protected quotations. However, Wedbush did not have any controls or procedures reasonably designed to ensure that its customers complied with this regulatory requirement.

44. As a result of Wedbush's lack of "direct and exclusive control" over risk settings designed to ensure ISO compliance, and its failure to have controls and procedures reasonably designed to ensure compliance with the ISO requirements of Regulation NMS, at least one Wedbush customer submitted ISOs without Wedbush's prior knowledge and without a broker-dealer acting to ensure compliance with the relevant regulatory requirements. In April 2011, Fillhart learned from an exchange that one of Wedbush's largest sponsored access customers was submitting ISOs even though Wedbush did not authorize the customer to submit ISOs and even though Wedbush had not allocated responsibility to another registered broker-dealer to ensure that ISOs submitted by the customer complied with Regulation NMS. Without Wedbush's knowledge, the customer and its third-party platform provider had enabled an order route that was configured to allow ISOs, even though the platform provider had previously informed Wedbush that the customer was not able to submit ISOs. This also demonstrated that it was unreasonable for Wedbush to rely on the written attestations that it received from the platform providers, as described above.

45. Because Wedbush had not authorized the customer to submit ISOs, Wedbush had not taken any steps to ensure that the ISOs complied with Regulation NMS. Fillhart instructed the platform provider to close the ISO route, but she did not directly close or disable the route and she knew that Wedbush did not have any controls or procedures to prevent a similar route from being enabled again in the future.

46. In November 2011, Fillhart learned that the same customer had again enabled an ISO route in its trading platform and submitted ISOs without Wedbush's knowledge. As in April 2011, Wedbush had not taken any steps to ensure that the ISOs complied with Regulation NMS because Wedbush had not authorized the customer to submit ISOs. These incidents demonstrate that Wedbush did not have "direct and exclusive control" over these risk settings as required by Rule 15c3-5(d), and did not have controls reasonably designed to ensure compliance with all regulatory requirements that must be satisfied on a pre-order entry basis.

Other Regulatory Requirements

47. Subsection (c)(2) of the Market Access Rule required Wedbush to have risk management controls and supervisory procedures that were reasonably designed to ensure compliance with all existing regulatory requirements. Wedbush did not have controls and procedures in connection with its market access business that were reasonably designed to ensure that Wedbush complied with all AML reporting and recordkeeping requirements applicable to Wedbush.

48. Exchange Act Rule 17a-8 requires broker-dealers to comply with the reporting, recordkeeping, and record retention requirements of the regulations adopted by the Department of the Treasury pursuant to the Bank Secrecy Act. The Bank Secrecy Act requires financial institutions such as broker-dealers to establish AML programs that include, among other things, internal policies, procedures, and controls, and authorizes the Department of the Treasury to adopt regulations prescribing minimum standards for AML programs. 31 U.S.C. §§ 5318(h)(1) and (2). Treasury regulations require broker-dealers to file reports of any suspicious transactions relevant to a possible violation of law or regulation, 31 C.F.R. § 1023.320, and state that broker-dealers regulated by a self-regulatory organization ("SRO") are deemed to satisfy the Bank Secrecy Act's AML program requirements if they comply with the AML program requirements of their SRO. 31 C.F.R. § 1023.210.

49. Wedbush's SRO, FINRA, requires its members to establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions as required by the Bank Secrecy Act and Treasury regulations thereunder. *See* FINRA Rule 3310. As described below, on numerous instances Fillhart became aware of potential wash trading and other forms of potential manipulation, but she did not cause Wedbush to file reports regarding the suspicious activity, and Wedbush's policies and procedures did not cause Wedbush to detect suspicious activity and file such reports.

50. Wedbush's WSPs asserted that it did not permit its customers to execute wash and pre-arranged trades. Wedbush's WSPs defined "wash trades" as "transactions which result in no beneficial change of ownership" and defined a "pre-arranged trade" as "an offer to sell coupled with an offer to buy back at the same or at an advanced price, or the reverse."

51. In most of the trading platforms used by Wedbush sponsored access customers, individual traders were identified by a unique trader ID. While most traders received a single trader ID, on some occasions a single trader had multiple trader IDs. Wedbush did not have any controls or filters to prevent a single trader from trading with himself or herself in a customer firm's account, or to prevent two different traders from trading with each other in a customer firm's account.

52. Most trading platforms used by Wedbush's customers had risk settings to prevent potential wash trades, but Wedbush had no controls or procedures to prevent customers or platform providers from deactivating the settings. Some exchanges offered functionality to block wash trades, but Wedbush had no controls or procedures requiring customers to use this anti-wash trade functionality.

53. Wedbush personnel responsible for filing suspicious activity reports pursuant to the Bank Secrecy Act relied on Fillhart and other employees in the Correspondent Services Division, which Bell oversaw, to review trading activity by sponsored access customers to determine whether it was relevant to potential violations of securities laws or regulations. But Bell and Fillhart knew that Wedbush did not have policies or procedures describing how Correspondent Services employees were to review trading to determine whether it was suspicious and should be reported.

54. The WSPs stated that Wedbush would review reports of potential wash trades from vendors and exchanges, determine whether there were potential securities violations, and if so, obtain representations from sponsored access customers regarding their internal wash trade reviews and systems.

55. A Wedbush employee who reported to Fillhart received reports of potential wash or pre-arranged trades from exchanges on a daily basis during the relevant period. For most of the trades on the reports, which involved two trader IDs in a single customer account, Fillhart did not ask the Wedbush employee to follow up with the customer firm because Fillhart assumed the two traders were independent and did not consider the trading suspicious. No one from Wedbush ever attempted to contact traders to determine whether they were pre-arranging their trades.

56. For trades with a single trader ID on both sides, Fillhart relied on the customer firm to follow up with the trader. On many occasions, the customer simply responded that it was not wash trading or was an error. On some occasions, the customer did not respond at all. Fillhart generally did not ask the Wedbush employee to follow up with customers for further explanation and did not report the trading to the AML officer as suspicious.

57. In February 2012, Fillhart learned from exchanges that numerous traders in the account of one of Wedbush's largest sponsored access customers appeared to be engaged in wash or pre-arranged trading. Fillhart determined that the customer or its platform provider had disabled the risk setting in the platform that would have prevented the trading. The customer informed Wedbush that it would either enable the risk setting or send future orders through a route that blocked wash trades. Fillhart did not directly enable the risk setting and did not cause Wedbush to adopt any procedures to ensure that the customer enabled it.

58. In March 2012, Fillhart learned that traders in the same customer account again appeared to be engaged in wash or pre-arranged trading. Because the customer had recently begun using an introducing broker-dealer, Wedbush notified personnel at the introducing broker-dealer, who responded that they were working to resolve the problem. Fillhart again did not directly enable the anti-wash trading risk setting in the platform and did not cause Wedbush to take steps to ensure that the customer or its introducing broker-dealer enabled it.

59. The customer informed Wedbush that it had disabled one of the traders involved in the incidents, but Wedbush did not directly disable any of the traders. Wedbush had no controls or

procedures for preventing traders that had been disabled by a customer from obtaining a new trader ID through the same or a different Wedbush customer account.

60. On multiple occasions, Fillhart learned from exchanges that traders in the same customer account appeared to be engaged in potentially manipulative trading referred to as "layering," which involves submitting and cancelling large numbers of non-*bona fide* orders on one side of the market in order to obtain executions at more favorable prices for smaller bona fide orders on the other side. *See, e.g., In the Matter of Hold Brothers On-Line Investment Services, LLC, et al.*, Admin. Proc. File No. 3-15046 (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 Cease-and-Desist Orders, dated Sept. 25, 2012), at 5-6.

61. As early as February 2011, Fillhart notified the customer of potential layering activity in its account and told the customer that layering "is a manipulative activity." Until at least September 2012, Fillhart continued receiving reports from exchanges of potential layering activity through the same customer account, but she did not cause Wedbush to develop or acquire any tools to detect or cause the reporting of potential layering activity and did not warn the customer's principals that the account would be disabled if the trading activity continued.

62. In late 2011, Bell and Fillhart met with another senior officer in the Correspondent Services Division to discuss the substantial compliance risks posed to Wedbush by sponsored access customers like the one that had been the subject of numerous reports of potential layering and wash trading and had been addressed in face-to-face meetings with Commission staff—the customer that had thousands of essentially anonymous foreign traders trading through a single Wedbush customer account. Bell, Fillhart, and the other officer decided not to terminate the customer's relationship with Wedbush, but agreed that Wedbush should not take on new market access customers with similar business models because of the compliance risks to Wedbush.

63. During the relevant period, Wedbush did not file any suspicious activity reports relating to potential layering and filed only two reports relating to potential wash or pre-arranged trading. More broadly, Fillhart knew that Wedbush did not review for a variety of manipulative trading practices, including fictitious orders, marking the open or marking the close, traders at a Wedbush customer trading a security between each other to manipulate the price of the security, manipulating securities prices through wash trades, or layering.

Authorization of Traders

64. Subsection (b) of the Market Access Rule requires a broker-dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through the use of its MPID or otherwise, to "establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks" of its market access business. Subsection (c)(2)(iii) of the Market Access Rule required Wedbush to have risk management controls and supervisory procedures that were reasonably designed to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by Wedbush, the broker-dealer with market access. As described below, for many of its largest sponsored access customers, Wedbush only pre-approved and authorized the principals for the account and relied on its customer to pre-approve and authorize the thousands of individual traders who received market access through the

account without reasonably designed controls and supervisory procedures to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker or dealer. Accordingly, Wedbush failed to have controls and procedures that complied with Subsection (c)(2)(iii) of the Market Access Rule. Wedbush also did not effectively allocate these obligations, to the extent permitted by Subsection (d)(1) of the Market Access Rule, to its registered broker-dealer customers.

65. Wedbush's WSPs asserted that sponsored access customers were required to provide authorized trader information to Wedbush "upon commencement of sponsored access and when a change occurs." The WSPs also asserted that Wedbush would verify authorized trader information annually. Wedbush did not have any controls or procedures requiring customers to obtain approval from Wedbush before authorizing new traders.

66. When Wedbush opened a sponsored access account, Wedbush employees obtained identifying information and performed background checks only on the principals of the entity opening the account, not on other individuals that the entity authorized to trade through the account. While customers sometimes copied a Wedbush employee on their emails instructing platform providers to authorize new traders to trade through the customer's account, Wedbush did not have any written policies or procedures for pre-approving or authorizing new traders for existing sponsored access accounts.

67. Some customer firms and platform providers used a one-page "AccountID creation form" that called for certain information about each authorized trader, but Wedbush did not require use of the form and Wedbush rarely obtained copies of the forms from customers. There was a section on the form for approval of the trader's access, but neither Wedbush nor the customers completed that section of the form.

68. For customer firms with hundreds or thousands of traders, Wedbush usually relied on the customer firm to maintain a list of authorized traders and their trader IDs. Beginning in September 2011, Wedbush employees who reported to Fillhart occasionally obtained lists of authorized traders from customer firms with large numbers of traders and ran searches by name to determine whether any traders were subject to sanctions or restrictions on business activity by the Office of Foreign Assets and Control (OFAC), an office with the Department of the Treasury that administers economic and trade sanctions based on U.S. foreign policy and national security goals. These searches were done after, not before, the customer firm extended market access to the traders. OFAC's programs are separate and distinct from the AML requirements imposed on broker-dealers by Exchange Act Rule 17a-8 and underlying Treasury regulations.

69. For customer firms with hundreds or thousands of traders, neither Fillhart nor Bell asked Wedbush employees to take any steps to verify trader names or identities or to speak to any of the traders. Bell and Fillhart knew that Wedbush relied exclusively on the customer firms, some of which were not registered broker-dealers, to confirm trader identities and oversee their trading strategies. Fillhart herself had the experience of being unable to find a list of trader information for a particular Wedbush client. Because of these facts, particularly the component of Wedbush's business that provided sponsored access to hundreds or thousands of traders through Wedbush's customers, Wedbush's controls and procedures for the pre-approval and authorization of traders were not reasonable. As noted above, Wedbush also did not effectively allocate these obligations, to the extent permitted by Subsection (d)(1) of the Market Access Rule, to its registered broker-dealer customers.

Review of Effectiveness of Market Access Controls and Procedures

70. Section (e) of the Market Access Rule required Wedbush to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access and to conduct a review of its market access business in accordance with written procedures at least annually. Wedbush did not have any written procedures for regularly reviewing the effectiveness of its market access controls and procedures, and Bell and Fillhart both acknowledged that they had primary responsibility for designing and implementing Wedbush's controls and procedures relating to its market access business. As described below, the only review relating in any way to the market access business that Wedbush conducted during the relevant period did not mention the Market Access Rule or any specific risk management controls or supervisory procedures relating to market access.

71. On Friday, March 23, 2012, in preparation for Wedbush's required certification of supervisory controls pursuant to SRO rules, one of Wedbush's Co-Chief Compliance Officers asked the two internal audit employees at Wedbush to review five areas of Wedbush's business, including one described as "High Frequency Trading." The memorandum containing this request did not mention the Market Access Rule, any other Commission rules, or sponsored access.

72. The internal audit employees prepared a written report dated Monday, March 26, 2012, describing their review, including one page relating to "High Frequency Trading/Exchange Traded Funds." The report did not mention the Market Access Rule, any other Commission rules, sponsored access, Wedbush's WSPs, or any specific risk management controls or supervisory procedures that Wedbush had adopted to comply with the Rule.

73. According to the report, the employees reviewed documents, observed procedures, and spoke with three employees in the Correspondent Services Division as part of the review. The report cited two specific steps—reviewing the checklist for onboarding new customers and observing software applications used for monitoring customer buying power and trading activities. The report noted that the software applications included risk management settings, but did not state that any specific settings were reviewed or tested.

74. The report concluded that, based on the internal audit employees' review, management's controls in the "High Frequency Trading/Exchange Traded Funds" area were adequate and functioning as intended.

75. The Co-Chief Compliance Officer incorporated this section of the report verbatim in a report that he sent to Wedbush's President and the rest of Wedbush's management team and Board on March 30, 2012. Like the internal audit report, this report did not mention the Market Access Rule, any other Commission rules, sponsored access, Wedbush's WSPs, or any specific risk management controls or supervisory procedures that Wedbush had adopted to comply with the Rule. No other reviews of the market access business were conducted by Wedbush employees during the relevant period.

76. Based on the report, as well as representations and assurances provided by Bell, Wedbush's President signed a certification dated March 30, 2012, citing SRO rules and Rule 15c3-5 (the Market Access Rule), and stating that the firm's risk management controls and supervisory procedures in connection with market access complied with Rule 15c3-5. For the reasons described above, that certification was inaccurate.

Preservation of Records

77. Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder require broker-dealers to preserve for three years originals of all communications received and copies of all communications sent relating to its business as such. Wedbush did not preserve originals or copies of communications containing trading instructions relating to ISOs submitted by some of its customers under a Wedbush MPID through third-party trading platforms. As a result, Wedbush employees could not determine which orders submitted by those customers during the relevant period were ISOs.

Violations

78. Section 15(c)(3) of the Exchange Act requires broker-dealers to comply with the Commission's rules regarding safeguards, financial responsibility, and related practices of broker-dealers. Rule 15c3-5 thereunder requires broker-dealers with market access to establish, document, and maintain a system of risk management controls and supervisory procedures that is reasonably designed to manage the financial, regulatory, and other risks of its market access business; to maintain direct and exclusive control over the market access controls and procedures; and to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access. As discussed above, Wedbush willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder because it did not maintain exclusive control over risk management controls in sponsored access trading platforms; did not have a system of risk management controls and supervisory procedures that was reasonably designed to ensure compliance with all regulatory requirements, including those that must be satisfied on a pre-order entry basis; did not have controls and procedures reasonably designed to restrict access to market access trading systems to persons and accounts pre-approved and authorized by Wedbush; did not establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access; and did not conduct an adequate review of its market access controls and procedures during the relevant period.

79. Under Section 21C(a) of the Exchange Act, a person is a cause of a securities violation if there is an underlying primary violation to which an act or omission of the person contributed and the person knew or should have known that his or her conduct would contribute to the violation. As discussed above, Bell and Fillhart each was a cause of Wedbush's violation of Rule 15c3-5 because their acts and omissions contributed to Wedbush's violation and they knew or should have known that their conduct would contribute to the violation.

80. Section 17(a) of the Exchange Act and Rule 17a-8 thereunder require broker-dealers to comply with the reporting, recordkeeping, and record retention requirements of the regulations adopted by the Department of the Treasury pursuant to the Bank Secrecy Act. Treasury regulations require broker-dealers to file reports of any suspicious transactions relevant to a possible violation of law or regulation. As discussed above, Wedbush willfully violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder because it failed to file reports of suspicious trading activity in connection with is market access business.

81. Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder require broker-dealers to preserve for three years originals of all communications received and copies of all communications sent relating to their business as such. As discussed above, Wedbush willfully

violated Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder because it failed to preserve originals or copies of communications containing trading instructions relating to ISOs submitted by its customers under a Wedbush MPID through third-party trading platforms.

82. Rule 203(b)(1) of Regulation SHO prohibits a broker-dealer from accepting or effecting a short sale order unless the broker-dealer has borrowed the security or entered into an arrangement to borrow the security, or has reasonable grounds to believe that the security can be timely borrowed, and has documented its compliance with Rule 203(b)(1). As discussed above, Wedbush willfully violated Rule 203(b)(1) of Regulation SHO because it allowed sponsored access customers to submit short-sale orders for securities that were not easy to borrow without first otherwise locating shares to borrow.

83. Rule 611(c) of Regulation NMS requires the broker-dealer responsible for routing an ISO to take reasonable steps to establish that the order meets the requirements of Rule 600(b)(30), which requires the broker-dealer routing the ISO to sweep the market by routing simultaneously additional orders, as necessary, to execute against the full size of all better-priced protected quotations. As discussed above, Wedbush willfully violated Rule 611(c) of Regulation NMS because it allowed sponsored access customers to submit ISOs without Wedbush taking reasonable steps to ensure that it satisfied the requirements for sending ISOs.

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 Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act, including but not limited to disgorgement, prejudgment interest, and civil penalties from Respondents pursuant to Section 21B of the Exchange Act; and

C. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 15(c)(3) and 17(a) of the Exchange Act and Rules 15c3-5, 17a-4, 17a-8, 203(b)(1), and 611(c) thereunder.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents each shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

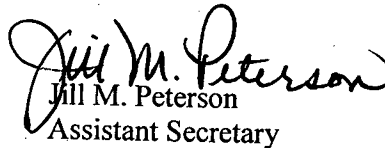
If any of the Respondents fails to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against that Respondent upon consideration of this Order, the allegations of which may be deemed to be 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 Respondents personally, by certified mail, or as otherwise provided by Rule 141 of the Commission's Rules of Practice, 17 C.F.R. § 201.141.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 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

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72345 / June 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15915

In the Matter of KENNETH GROSS, 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 Kenneth Gross ("Respondent" or "Gross").

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, and except as otherwise provided herein in Section IV, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Gross was an independent contractor of Your Best Memories International Inc. ("YBMI"), a Nevada corporation located in Los Angeles, California, and was responsible for soliciting individuals to invest in YBMI from October 2010 to November 2012. Gross has held a Series 15 securities license (for Registered Foreign Currency Options Representatives) and a Series 4 securities license (for Registered Options Principals). Gross, 68 years old, is a resident of Northridge, California.

2. On March 17, 2014, a final judgment was entered by consent against Gross, permanently enjoining him from future violations of Sections 5(a) and (c) of the Securities Act of 1933 ("Securities Act") and Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Robert Hurd, et al., Civil Action Number 2:13-CV-04464-RGK-JCG, in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that Gross sold YBMI securities without being registered as a broker-dealer or associated with a registered broker-dealer. The complaint also alleged that Gross sold unregistered securities in YBMI.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Gross be, and hereby is:

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

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

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9597 / June 9, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72352 / June 9, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3847 / June 9, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31073 / June 9, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15918

In the Matter of

DENNIS J. MALOUF,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b), 15C(c) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, 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), 15C(c) and 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 Dennis J. Malouf ("Malouf" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. This proceeding arises from a fraudulent scheme to secretly pay trading commissions to Dennis Malouf, the former chief executive officer and majority owner of UASNM, Inc. ("UASNM"), a registered investment adviser. Between 2008 and 2011, Malouf directed UASNM client bond trades to a branch office of a broker-dealer ("Broker-Dealer") that he had formerly owned. The buyer and new manager of that branch ("Branch Manager") and Malouf had entered into a secret oral agreement that Branch Manager would forward to Malouf substantially all of the commissions from UASNM's bond trading, which netted Malouf approximately $1.1 million between 2008 and 2011. This commission arrangement, and the resulting material conflict of interest, were not disclosed to UASNM's clients.

2. Malouf's fraudulent commission scheme resulted in several other violations of the federal securities laws. First, Malouf caused UASNM's website to make false or misleading statements regarding the firm's purported impartial investment advice, best execution, and fee structure. Second, Malouf failed to seek best execution on client bond trades by directing the vast majority of these trades to Broker-Dealer without obtaining competing bids from other broker-dealers. Finally, Malouf acted as an unregistered broker-dealer by receiving approximately $1.1 million in commission payments from Branch Manager for directing his clients' bond trades to Broker-Dealer.

B. RESPONDENT

3. **Dennis J. Malouf**, age 54, is a resident of Albuquerque, New Mexico. Malouf was the chief executive officer and majority owner of UASNM from September 2004 until May 2011, when he was terminated. He is currently the sole owner and president of an investment adviser registered with the State of New Mexico.

C. OTHER RELEVANT ENTITY

4. **UASNM, Inc.** is a New Mexico corporation located in Albuquerque, New Mexico, that registered as an investment adviser with the Commission on September 4, 2004. UASNM provides discretionary advisory services primarily to individuals, charitable organizations, and employee benefit plans. UASNM's most recent Form ADV reported approximately $275 million in assets under management. UASNM is named as a respondent in a separate administrative proceeding relating to the misconduct described in this Order.

D. FACTS

Relationship between UASNM and a Branch Office of Broker-Dealer

5. In 2004, Malouf purchased a majority interest in UASNM and registered the firm as an investment adviser with the Commission. At that time, Malouf was also associated as a registered representative and owned a branch office of Broker-Dealer. The Broker-Dealer branch owned by Malouf sub-leased and occupied a portion of UASNM's office space.

6. In 2007, Broker-Dealer became concerned about potential conflicts of interest and supervision risks arising from Malouf's work at UASNM, and asked him to choose between associating with UASNM or Broker-Dealer. Malouf decided to continue his advisory work at UASNM, and to terminate his association as a registered representative and owner of a branch office of Broker-Dealer.

7. As a result, at the end of 2007, Malouf terminated his registration with Broker-Dealer, and he transferred his Broker-Dealer customers either to UASNM, or to the new Branch Manager. Branch Manager continued to operate the Broker-Dealer office within UASNM's office space until June 2011, when UASNM required Branch Manager to find a new office location as a result of his involvement in the fraudulent commission scheme.

The Branch Manager Secretly Paid Malouf All of the Commissions Earned on UASNM Bond Trades

8. Malouf was considered the bond expert within UASNM based upon his prior experience in trading bonds, and as a result, he handled most of the bond trading on behalf of UASNM clients. From 2008 to 2011, Malouf selected Branch Manager and Broker-Dealer to execute the overwhelming majority of bond transactions that he directed on behalf of UASNM clients. Between January 2008 and May 2011, UASNM placed over 200 bond trades through Broker-Dealer, representing approximately 90% of its bond trading in this period. During this period, Malouf, through UASNM, effected transactions in securities including U.S. Treasuries, federal agency bonds, and municipal bonds, and averaged between $30 million and $40 million in total trades per year.

9. Between January 2008 and April 2011, Branch Manager earned approximately $1.1 million in commissions from UASNM bond transactions. Then, pursuant to a secret oral agreement with Malouf that was not disclosed to others at UASNM or Broker-Dealer or to UASNM clients, Branch Manager paid approximately $1.1 million to Malouf.

10. Malouf claims that he sold the Broker-Dealer branch to Branch Manager at the end of 2007, and entered into a written Purchase of Practice Agreement ("PPA") at that time enabling him to share in 40% of the overall branch revenues for a four year period. However, the PPA was a sham to disguise the secret commission payments that Branch Manager had been making to Malouf since the beginning of 2008. Branch Manager's payments to Malouf were not consistent with the terms of the PPA, and instead were consistent with his secret oral agreement with

Malouf. Furthermore, Malouf and Branch Manager did not sign the sham PPA until approximately June 2010, after Broker-Dealer discovered that Branch Manager had been making secret commission payments to Malouf.

Malouf Failed to Disclose and Caused UASNM to Fail to Disclose His Receipt of Commissions from Branch Manager and the Resulting Conflicts of Interest

11. UASNM's Forms ADV Part II dated February 4, 2008, August 20, 2008, December 1, 2008, October 1, 2009, January 1, 2010, March 18, 2010, April 12, 2010, and UASNM's Form ADV Part 2A dated March 2011, failed to disclose Malouf's arrangement with Branch Manager, or the resulting conflicts of interest with respect to UASNM's execution of client bond trades through Broker-Dealer. Specifically, UASNM's Forms ADV made no disclosure that Malouf was receiving commissions or payments of any kind from Branch Manager.

12. Item 12 of UASNM's Forms ADV Part II dated February 4, 2008, August 20, 2008, December 1, 2008, October 1, 2009, January 1, 2010, March 18, 2010, April 12, 2010 and UASNM's Form ADV Part 2A dated March 2011also made misleading disclosures relating to its best execution process which suggested that numerous factors were being considered in selecting a broker. For example, Item 12 of UASNM's Form ADV Part II dated April 12, 2010 disclosed that the broker recommended by UASNM was not "based upon any arrangement between the recommended broker and UAS[NM]" and instead was "dependent upon a number of factors, including the following: trade execution, custodial services, trust services, record keeping, and research, and/or ability to access a wide variety of securities. UAS[NM] reviews on a periodic and systematic basis its third-party relationships to ensure it is fulfilling its fiduciary duty to seek best execution on Client transactions." In reality, Malouf was using Broker-Dealer almost exclusively to execute the overwhelming majority of UASNM's bond trades primarily based upon his secret agreement with Branch Manager.

13. In addition, Item 12 of UASNM's Form ADV Part II dated April 12, 2010 affirmatively misrepresented that "employees of UASNM are not registered representatives of Schwab, Raymond James or Fidelity, and do not receive any commissions or fees from recommending these services." Given Malouf's receipt of commissions from Branch Manager for executing UASNM client bond trades through Broker-Dealer, this statement was false and misleading.

14. Items 10 and 12 of UASNM's Form ADV Part 2A dated March 2011 disclosed for the first time that Malouf had sold his interest in a Broker-Dealer branch in exchange for a series of payments, and that an incentive could exist for UASNM to utilize Broker-Dealer to generate revenue to fulfill the payments due to Malouf. However, this new disclosure was misleading in that it generally referenced UASNM's incentive to generate revenue for Broker-Dealer, but failed to adequately disclose the extent of the potential conflict of interest – specifically, Malouf's continued receipt of commissions from UASNM's bond trading pursuant to his secret agreement with Branch Manager.

15. UASNM's misstatements and omissions regarding Malouf's receipt of commissions from Branch Manager were material because Malouf's conflict of interest led him to

execute bond trades through Branch Manager and Broker-Dealer even where this may not have been in the best interests of UASNM clients.

16. As UASNM's CEO, Malouf was ultimately responsible for ensuring that the firm's Form ADV disclosures were complete and accurate. Malouf reviewed each of UASNM's Forms ADV before they were filed, and he focused particularly on disclosures relating to himself and Broker-Dealer. As the architect of the secret commission arrangement with Branch Manager and the primary trader of bonds for UASNM clients, Malouf was aware of the conflict of interest posed by the arrangement. Yet Malouf did not disclose his secret commission arrangement with Branch Manager to others at UASNM or its outside compliance consultant to enable them to disclose the arrangement or the resulting conflicts of interest.

Malouf Aided and Abetted and Caused UASNM to Make Misleading Claims on Its Website

17. Between 2008 and 2011, UASNM's website made the following statements:

> "Uncompromised Objectivity Through Independence: UAS[NM] is not owned by any 'product' company nor compensated by any commissions. This allows us to provide investment advice void of conflicts of interest. UAS[NM] may place trades through multiple sources, ensuring that best cost/service/execution mix is met for clients."
>
> "We do not accept commissions and we vigorously maintain our independence to ensure absolute objectivity drives our decisions in managing our clients' portfolios."

18. Given Malouf's agreement with Branch Manager to receive substantially all commission payments from UASNM client transactions through Broker-Dealer, these statements on UASNM's website were materially false and misleading because: (i) UASNM's purported independence was compromised by Malouf's undisclosed incentives to place trades through Broker-Dealer; (ii) Malouf was in fact compensated by commissions; (iii) Malouf's receipt of commission-based compensation presented a material conflict of interest; and (iv) UASNM did not obtain competing bids from various broker-dealers due to Malouf's undisclosed conflict and thus failed to seek best execution on certain trades.

19. Malouf aided and abetted and caused UASNM's deceptive advertising because as the CEO, majority owner, and lead salesman for the firm, he was familiar with the contents of the website, and had ultimate responsibility for reviewing and approving it. Malouf was the only UASNM employee with knowledge of his secret agreement with Branch Manager, but he failed to inform the Chief Compliance Officer or others at UASNM about his secret agreement, and as a result Malouf caused the statements made on the firm's website to be materially false or misleading.

Malouf Failed to Seek Best Execution on Bond Trades

20. Between 2008 and 2011, Malouf told other UASNM employees, including the Chief Compliance Officer and UASNM's outside compliance consultant, that he often obtained three competing bids in order to determine the best price prior to making bond trades. However, Malouf did not obtain competing bids. Instead, between 2008 and 2011, Malouf nearly always selected Branch Manager's branch of Broker-Dealer to execute bond trades on behalf of UASNM clients. As a result, Malouf failed to seek best execution for UASNM's clients.

21. Because UASNM and Malouf failed to seek best execution from January 2008 through April 2011, UASNM clients paid higher commissions than were reasonably necessary for their transactions in approximately $95 million in U.S. Treasury bonds and federal agency bonds.

Malouf Acted as an Unregistered Broker and Government Securities Broker

22. Between 2008 and 2011, Malouf effected transactions in, and induced or attempted to induce the purchase or sale of, securities including government securities. During this time, he was not registered with the Commission as a broker or dealer in accordance with Section 15(b) of the Exchange Act, and he was not associated with a broker or dealer other than a natural person. He also was not registered with the Commission as a government securities broker in accordance with Section 15C(a)(2) of the Exchange Act. Nonetheless, he was engaged in the business of effecting transactions in government securities and other securities for accounts of UASNM and UASNM clients. He regularly was involved in significant aspects of effecting transactions in government and municipal securities on behalf of UASNM clients, and he actively solicited investors and provided advice as to the merits of securities. Moreover, pursuant to his secret agreement with Branch Manager, he received substantially all of the commissions generated by UASNM client trades placed through Broker-Dealer.

E. <u>VIOLATIONS</u>

23. As a result of the conduct described above, Malouf willfully violated Sections 17(a)(1) and 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

24. As a result of the conduct described above, Malouf willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

25. As a result of the conduct described above, Malouf willfully violated Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

26. As a result of the conduct described above, Malouf willfully aided and abetted and caused UASNM's violations of Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which prohibit publishing, circulating, or distributing advertisements containing untrue statements of material facts or that were otherwise false or misleading.

27. As a result of the conduct described above, Malouf willfully violated Section 15(a)(1) of the Exchange Act, which makes it unlawful for any broker or dealer to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered with the Commission pursuant to Section 15(b) of the Exchange Act (or, if a natural person, associated with a registered broker-dealer other than a natural person).

28. As a result of the conduct described above, Malouf willfully violated Section 15C(a)(1)(A) of the Exchange Act, which makes it unlawful for any government securities broker or dealer to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any government security, unless such government securities broker or dealer is registered with the Commission pursuant to Section 15C(a)(2) of the Exchange Act.

29. In the alternative, as a result of the conduct described above, Malouf also willfully aided and abetted and caused UASNM's violations of Sections 206(1), 206(2), and 207 of the Advisers Act.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Sections 15(b) and 15C(c) 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 Respondent 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 Respondent pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

E. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Malouf should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 17(a)(1) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder, Sections 15(a)(1) and 15C(a)(1)(A) of the Exchange Act, and Sections 206(1), 206(2), 206(4), and 207 of the Advisers Act and Rule 206(4)-1(a)(5) thereunder; whether Malouf 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 Malouf 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(j) of the Advisers 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 Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

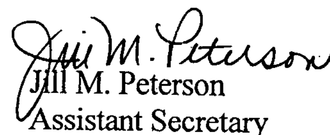
If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.



Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 6, 2014

In the Matter of **Alternative Energy Partners, Inc. and SK3 Group, Inc.** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

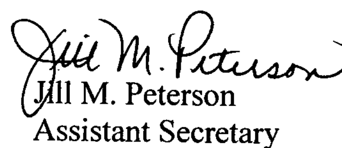
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Alternative Energy Partners, Inc. because of questions concerning the accuracy and adequacy of publicly available information about the company, including, among other things, its business activities, the control of the company, and trading in its securities. Alternative Energy Partners, Inc. is a Florida corporation with a business address in Boca Raton, Florida and its common stock is quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link") under the ticker symbol AEGY.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of SK3 Group, Inc. because of questions concerning the accuracy and adequacy of publicly available information about the company, including, among other things, its business activities, the control of the company, and trading in its securities. SK3 Group, Inc. is a Delaware corporation with a business address in Los Angeles, California and its common stock is quoted on OTC Link under the ticker symbol SKTO.

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 June 6, 2014, through 11:59 p.m. EDT on June 19, 2014.

By the Commission.



Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9596 / June 6, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72339 / June 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15912

In the Matter of **LIQUIDNET, INC.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Liquidnet, Inc., ("Liquidnet" 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 Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of

1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. Liquidnet is a broker-dealer registered with the Commission and operates a block-trading alternative trading system ("ATS"), or dark pool, for large institutional investors.[1]

2. Between 2009 and 2012, Liquidnet sought to expand its business and to find additional sources of liquidity for its ATS by offering its services to corporate issuers and control persons of corporate issuers, as well as to private equity and venture capital ("PE/VC") firms looking to execute large equity capital markets transactions. This effort was undertaken, in part, through the use of confidential information about Liquidnet customers' intentions to buy or sell securities. By improperly using that information and not keeping it confidential, Liquidnet violated the promises that it had made to its customers and failed to meet its obligations under Regulation ATS.

3. ATSs are subject to Regulation ATS, as well as other rules, including Regulation NMS, Exchange Act Rule 15c3-5 (known as the market access rule), and other rules and regulations governing the registration and operation of broker-dealers. One important rule that protects subscribers of an ATS is Rule 301(b)(10) of Regulation ATS, which requires that an ATS establish safeguards and procedures to protect subscribers' confidential trading information and adopt and implement adequate oversight procedures to ensure that the safeguards and procedures for protecting subscribers' confidential trading information are followed. 17 C.F.R. § 242.301(b)(10). In adopting Rule 301(b)(10), the Commission recognized "the sensitive nature of the trading information subscribers send to alternative trading systems" and stated its intention that Rule 301(b)(10) "prevent the disclosure or the use of information about a customer's trading orders." Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 40760, 63 Fed. Reg. 70844, 70879 (Dec. 22, 1998) ("Adopting Release").[2]

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[1] An ATS is "any organization, association, person, group of persons, or system: (1) [t]hat constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of [Exchange Act Rule 3b-16]; and (2) [t]hat does not: (i) [s]et rules governing the conduct of subscribers other than the conduct of subscribers' trading on such [ATS]; or (ii) [d]iscipline subscribers other than by exclusion from trading." Regulation ATS, Rule 300(a), 17 C.F.R. § 242.300(a).

[2] Indeed, the Commission noted that unless a subscriber consents, an ATS "should not disclose information regarding trading activities of such subscribers to other subscribers that could not be ascertained from viewing the [ATS's] screens directly at the time the information is conveyed." Adopting Release at 70879.

Commissioner Aguilar
Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3846 / June 9, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15917

In the Matter of

UASNM, INC.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against UASNM, Inc. ("UASNM" 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 Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. This proceeding arises from misconduct with respect to client bond trading by UASNM, Inc. ("UASNM"), a registered investment adviser, and its former chief executive officer and majority owner, Dennis Malouf ("Malouf"). Between 2008 and 2011, Malouf directed UASNM client bond trades to a branch office that he had formerly owned of another broker-dealer ("Broker-Dealer"). The new manager of that branch ("Branch Manager"), and Malouf had entered into a secret oral agreement that Branch Manager would forward to Malouf substantially all of the commissions from UASNM's bond trading, which amounted to approximately $1.1 million in payments to Malouf between 2008 and 2011. This commission arrangement, and the resulting material conflict of interest, were not disclosed to UASNM's clients. In addition, UASNM's website made statements about impartial investment advice, best execution, and commissions which were false or misleading in light of this secret oral agreement.

2. UASNM, acting through Malouf, also failed to seek best execution by directing the vast majority of client bond trades to Broker-Dealer without obtaining competing bids from other broker-dealers. Finally, UASNM failed to adopt and implement reasonable policies relating to best execution, and failed reasonably to supervise Malouf with respect to his client bond trading.

Respondent

3. **UASNM, Inc.** is a New Mexico corporation located in Albuquerque, New Mexico, that registered as an investment adviser with the Commission on September 4, 2004. UASNM provides discretionary advisory services primarily to individuals, charitable organizations, and employee benefit plans. UASNM's most recent Form ADV reported approximately $279 million in assets under management.

Other Relevant Individual

4. **Dennis J. Malouf**, age 54, is a resident of Albuquerque, New Mexico. Malouf was the chief executive officer and majority owner of UASNM from September 2004 until May 2011, when he was terminated. He is currently the sole owner and president of an investment adviser registered with the State of New Mexico. Malouf is named as a respondent in a separate administrative proceeding relating to his misconduct described in this Order.

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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.

Facts

Relationship between UASNM and a Branch Office of Broker-Dealer

5. In 2004, Malouf purchased a majority interest in UASNM and registered the firm as an investment adviser with the Commission. At that time, Malouf was also associated as a registered representative and owned a branch office of Broker-Dealer. The Broker-Dealer branch owned by Malouf sub-leased and occupied a portion of UASNM's office space. In 2007, Broker-Dealer became concerned about potential conflicts and supervision risks arising from Malouf's work at UASNM, and asked him to choose between associating with UASNM or Broker-Dealer. Malouf decided to continue his advisory work at UASNM, and to terminate his association as a registered representative and owner of a branch office of Broker-Dealer. As a result, at the end of 2007, Malouf terminated his registration with Broker-Dealer, and he transferred his Broker-Dealer customers either to UASNM, or to the new Branch Manager of the Broker-Dealer. Branch Manager continued to operate the Broker-Dealer office within UASNM's office space until June 2011, when UASNM required Branch Manager to find a new office location as a result of his involvement in Malouf's misconduct described below.

UASNM Terminated Malouf and Reported Potential Violations to Commission Staff

6. In May 2011, the minority owners of UASNM, acting in their capacities as directors, voted to terminate Malouf as an officer, director and employee of UASNM based on various allegations of misconduct. Malouf challenged the validity of this termination, which led to a lawsuit filed by UASNM against Malouf to remove him from the company ("the Lawsuit"). During the Lawsuit, UASNM's attorneys subpoenaed transaction records from Broker-Dealer, as well as bank account statements for Malouf and Branch Manager. In reviewing those records, UASNM discovered that from January 2008 through April 2011, Branch Manager had secretly forwarded to Malouf approximately $1.1 million in commissions earned from UASNM client bond trades that Malouf had executed through Broker-Dealer. In the Lawsuit, UASNM also learned that Malouf had placed all UASNM bond trades through Broker-Dealer without obtaining competing bids, and as a result, UASNM clients had paid unnecessarily high markups and markdowns on those trades.

7. In September 2011, UASNM and Malouf settled the Lawsuit. Among other things, they agreed that UASNM would place $850,000 in escrow to cover potential liability resulting from UASNM's plan to report possible best execution failures to the Commission (the "Escrow Account"). A New Mexico state court (the "State Court") currently retains jurisdiction to interpret and enforce the settlement agreement under which the Escrow Account was established. See UASNM v. Malouf (Second Judicial District Court, Bernalillo County, New Mexico Cause No. CV-2011-05595). In October 2011, UASNM reported to Commission staff a potential breach of fiduciary duty by Malouf with regard to bond trading on behalf of UASNM clients and other potential violations.

Branch Manager Secretly Paid Malouf All of the Commissions Earned on UASNM Bond Trades

8. Malouf was considered the bond expert within UASNM based upon his prior experience in trading bonds, and as a result, he handled most of the bond trading on behalf of UASNM clients. From 2008 to 2011, Malouf selected Branch Manager and Broker-Dealer to execute all bond transactions that he directed on behalf of UASNM clients. Therefore, between January 2008 and May 2011, UASNM placed over 200 bond trades through Broker-Dealer, representing approximately 90% of its bond trading during the period. During this period, UASNM traded U.S. Treasuries, federal agency bonds, and municipal bonds, and averaged between $30 million and $40 million in total trades per year.

9. Between January 2008 and April 2011, Branch Manager earned approximately $1.1 million in commissions from UASNM bond transactions. Then, pursuant to an oral agreement with Malouf that was not disclosed to others at UASNM or Broker-Dealer or to UASNM clients, Branch Manager paid approximately the same amount to Malouf.

UASNM Failed to Disclose Malouf's Receipt of Commissions from Branch Manager and the Resulting Potential Conflicts of Interest

10. UASNM's Forms ADV Part II dated February 4, 2008, August 20, 2008, December 1, 2008, October 1, 2009, January 1, 2010, March 18, 2010, April 12, 2010, and UASNM's Form ADV Part 2A dated March 2011 failed to disclose Malouf's arrangement with Branch Manager, or the resulting conflicts of interest. Specifically, UASNM made no disclosure that Malouf was receiving commissions or continuing payments of any kind from Branch Manager.

11. Item 12 of UASNM's Forms ADV Part II dated February 4, 2008, August 20, 2008, December 1, 2008, October 1, 2009, January 1, 2010, March 18, 2010, April 12, 2010 and UASNM's Form ADV Part 2A dated March 2011 also made misleading disclosures relating to its best execution process which suggested that numerous factors were being considered in selecting a broker (including trade execution, custodial services, trust services, recordkeeping, research and access to a wide variety of securities) and that it was not based "upon any arrangement between the recommended broker and UAS[NM]." In reality, Malouf was using Broker-Dealer to execute the overwhelming majority of UASNM's bond trades primarily based upon his secret agreement with Branch Manager.

12. In addition, Item 12 of UASNM's Form ADV Part II dated April 12, 2010 affirmatively misrepresented that "employees of UASNM are not registered representatives of [any broker-dealers], and do not receive any commissions or fees from recommending these services." Given Malouf's receipt of commissions from Branch Manager for recommending UASNM client bond trades through Broker-Dealer, this statement was false and misleading.

13. Items 10 and 12 of UASNM's Form ADV Part 2A dated March 2011 disclosed for the first time that Malouf had sold his interest in a Broker-Dealer branch in exchange for a series of payments, and that an incentive could exist for UASNM to utilize Broker-Dealer to generate

revenue that could be utilized to fulfill the payments due to Malouf. However, this new disclosure was inadequate in that it generally referenced revenue generation for Broker-Dealer, rather than Malouf's plan to receive all of the commissions from UASNM's bond trading pursuant to an agreement with Branch Manager.

14. UASNM's misstatements and omissions regarding Malouf's receipt of commissions from Branch Manager were material because Malouf's conflict of interest led him to execute bond trades through Branch Manager and Broker-Dealer even where this may not have been in the best interests of UASNM clients.

UASNM Made Misleading Claims on Its Website

15. Between 2008 and 2011, UASNM's website made the following statements:

> "Uncompromised Objectivity Through Independence: UAS[NM] is not owned by any 'product' company nor compensated by any commissions. This allows us to provide investment advice void of conflicts of interest. UAS[NM] may place trades through multiple sources, ensuring that best cost/service/execution mix is met for clients."
>
> "We do not accept commissions and we vigorously maintain our independence to ensure absolute objectivity drives our decisions in managing our clients' portfolios."

16. Given Malouf's agreement with Branch Manager to receive all commission payments from UASNM client transactions through Broker-Dealer, these statements on UASNM's website were materially false and misleading because: (i) UASNM's purported independence was compromised by Malouf's undisclosed incentives to place trades through Broker-Dealer; (ii) Malouf was in fact compensated by commissions; (iii) Malouf's receipt of commission-based compensation presented a material conflict of interest; and (iv) Malouf's undisclosed conflict caused UASNM to not obtain competing bids from various broker-dealers, thereby causing UASNM to fail to seek best execution on certain trades.

UASNM Failed to Seek Best Execution on Bond Trades

17. Between 2008 and 2011, Malouf told other UASNM employees, including the Chief Compliance Officer, that he often obtained three competing bids in order to determine the best price prior to making bond trades. However, Malouf did not obtain competing bids. Instead, between 2008 and 2011, Malouf always selected Branch Manager and Broker-Dealer to execute bond trades on behalf of UASNM clients, and a result, Malouf failed to follow any process for achieving best execution.

18. Because UASNM and Malouf failed to obtain competing bids from January 2008 through April 2011, UASNM clients paid higher markups and markdowns than were reasonably necessary for their transactions in approximately $95 million in U.S. Treasury bonds and federal

agency bonds, resulting in approximately $506,083.74 in additional markups and markdowns and interest thereon across 221 client accounts.

UASNM Failed to Adopt and Implement Reasonable Best Execution Policies and Failed Reasonably to Supervise Malouf

19. UASNM's best execution policy was not adequately tailored to its actual portfolio management. UASNM's Compliance Manual inaccurately stated in relevant part that: "UASNM does not regularly invest in any publicly traded equity securities or fixed income instruments. Instead, UASNM primarily recommends that its clients invest in mutual funds. As such, UASNM does not face the same issues relating to best execution that an adviser that regularly invests directly in equities and fixed income securities." In fact, in each year between 2008 and 2011, UASNM made between $30 million and $40 million in fixed income investments on behalf of clients.

20. UASNM's Compliance Manual generally required it to follow an unspecified process to seek best execution of client trades. However, UASNM failed to follow any process to seek best execution for fixed income trades.

21. Also, from 2008 through 2011, UASNM did not conduct any periodic review of its efforts to seek best execution for fixed income trading, or maintain any related documentation.

22. Finally, although UASNM's Compliance Manual stated that the Investment Committee was responsible for making trading decisions, in fact, fixed income trading decisions were made primarily by Malouf. UASNM did not assign anyone to supervise Malouf or the trading process generally. In practice, no UASNM employee directly supervised Malouf during his day-to-day execution of client bond trades. Moreover, no supervisor subsequently reviewed Malouf's trades or his purported bid process as to best execution. As a result, Malouf operated entirely without supervision as to his bond trading.

Findings

23. As a result of the conduct described above, UASNM willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

24. As a result of the conduct described above, UASNM willfully violated Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

25. As a result of the conduct described above, UASNM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which prohibit publishing,

circulating, or distributing advertisements containing untrue statements of material facts or that were otherwise false or misleading.

26. As a result of the conduct described above, UASNM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder by the adviser and its supervised persons.

27. As a result of the conduct described above, UASNM failed reasonably to supervise Malouf, within the meaning of Advisers Act Section 203(e)(6), with a view to preventing violations of the securities laws.

Undertakings

Respondent has agreed to the following undertakings:

28. Notice to Advisory Clients: Within thirty (30) days of entry of this Order, Respondent shall a provide a copy of the Order via mail, email, or other such method as may not be unacceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff, to each of the Respondent's clients that have existed from January 1, 2008 to the date of the entry of this Order.

29. Compensatory Payment to Affected Clients: UASNM has undertaken to pay $506,083.74 from the Escrow Account to compensate affected clients for the additional markups and markdowns paid by those clients as described in Paragraph 18 (the "Compensatory Payment"). UASNM undertakes to make the Compensatory Payment in accordance with and subject to any limitations under the settlement agreement under which the Escrow Account was established (including any limitation or prohibition that may be ordered by the State Court).

30. Independent Compliance Consultant. Respondent has undertaken:

a. to hire, within 90 days of the Order, an Independent Compliance Consultant not unacceptable to the staff of the Commission. Respondent shall require the Independent Compliance Consultant to review the Respondent's compliance program, including its policies relating to supervision and best execution. Respondent shall cooperate fully with the Independent Compliance Consultant and shall provide the Independent Compliance Consultant with access to any of its files, books, records and personnel as reasonably requested for review; provided, however, that Respondent need not provide access to materials as to which Respondent may assert a valid claim of the attorney-client privilege. The Independent Compliance Consultant shall maintain the confidentiality of any materials and

information provided by Respondent, except to the extent such materials or information are included in the Report described below;

b. to require that, at the conclusion of the review, which in no event shall be more than 180 days after the date of the Order, the Independent Compliance Consultant shall submit a Report to Respondent and the staff of the Commission. The Report shall include a description of the review performed, the conclusions reached, the Independent Compliance Consultant's recommendation for changes in or improvements to policies and procedures, and a procedure for implementing the recommended changes in or improvements to the procedures;

c. to adopt all recommendations contained in the Report of the Independent Compliance Consultant; provided, however, that within 30 days after receipt of the Report, Respondent shall in writing advise the Independent Compliance Consultant and the staff of the Commission of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that Respondent considers unnecessary or inappropriate, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose;

d. that as to any recommendation with respect to the policies and procedures of Respondent on which Respondent and the Independent Compliance Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 60 days after Respondent's receipt of the Independent Compliance Consultant's Report. In the event Respondent and the Independent Compliance Consultant are unable to agree on an alternative proposal acceptable to the staff of the Commission, Respondent will abide by the determinations of the Independent Compliance Consultant; provided, however, that Respondent may petition the Commission staff for relief from the recommendation;

e. that Respondent (i) shall not have the authority to terminate the Independent Compliance Consultant without the prior written approval of the staff of the Commission before the completion of the Report; (ii) shall compensate the Independent Compliance Consultant, and persons engaged to assist the Independent Compliance Consultant, for services rendered pursuant to the Order at their reasonable and customary rates; (iii) shall not be in and shall not have an attorney-client relationship with the Independent Compliance Consultant and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Independent Compliance Consultant from transmitting any information, reports, or documents to the staff of the Commission;

f. to require the Independent Compliance Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Compliance 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. The agreement will also provide that the Independent Compliance Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Compliance Consultant in performance of his/her duties under this Order shall not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with 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; and

g. to preserve for a period of not less than five (5) years from the date of the Order, the first two years in an easily accessible place, any record of Respondent's compliance with the undertakings set forth in this paragraph.

31. Certifications of Compliance by Respondent: Respondent shall certify, in writing, compliance with the undertakings in Paragraphs 28 and 30 according to the timelines 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 Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Kurt L. Gottschall, Assistant Regional Director, Asset Management Unit, Securities and Exchange Commission, 1801 California Street, Suite 1500, Denver CO 80202, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

32. Deadlines: For good cause shown, Commission staff may extend any of the procedural dates relating to the undertakings in Paragraphs 28-31. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend of federal holiday, the next business day shall be considered the last day.

UASNM's Cooperation and Remedial Efforts

33. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff. In determining whether to accept the Offer, the Commission has further considered the undertakings set forth in Paragraphs 28 and 29.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent UASNM cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2), 206(4) and 207 of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 promulgated thereunder.

B. Respondent UASNM is censured.

C. Respondent shall, within 60 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 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 UASNM 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 Kurt L. Gottschall, Assistant Regional Director, Asset Management Unit, Securities and Exchange Commission, 1801 California Street, Suite 1500, Denver CO 80202.

D. The Commission will hold any penalties paid in this proceeding pending a decision whether the Commission, in its discretion, will seek to distribute funds or transfer them to the U.S. Treasury. The Commission may distribute civil money penalties collected in this proceeding if, in its discretion, the Commission orders the establishment of a Fair Fund ("Fair Fund distribution") pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. Regardless of whether any such Fair Fund distribution is made, amounts

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

E. Respondent shall comply with the undertakings enumerated in Paragraphs 30 and 31 above.

By the Commission.

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. 72353 / June 9, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3848 / June 9, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15919

In the Matter of

CHRISTOPHER B. MINTZ,

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 Christopher B. Mintz ("Mintz" 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 admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings in Sections III.2. and III.3. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the

Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Between approximately 2003 and 2009, Mintz was a registered representative and investment adviser representative with LPL Financial Corporation (a dually registered broker-dealer and investment adviser) in LPL's Cary, North Carolina office. Mintz, 40 years old, is a resident of Raleigh, North Carolina.

2. On September 9, 2009, Mintz pled guilty to one count of fraud by an investment adviser in the criminal action against him in violation of Title 15 United States Code, Sections 80b-6 and 80b-17 before the United States District Court for the Eastern District of North Carolina (United States v. Christopher B. Mintz, Docket No. 5:09-CR-194). Mintz was sentenced to a prison term of 48 months followed by three years of supervised release and ordered to make restitution in the amount of $1,237,754.97.

3. The count of the criminal information to which Mintz pled guilty alleged, inter alia, that between December 2005 and October 2008 Mintz, by use of the mails and by means of interstate commerce, knowingly defrauded two investment advisory clients by embezzling the clients' securities and other assets for his personal use.

IV.

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

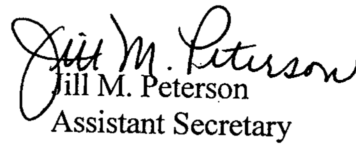
Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent Mintz be, and hereby is:

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

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially

waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.



Jill M. Peterson
Assistant Secretary

Chair White
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3851 / June 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15922

In the Matter of SAUL MEYER 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 Saul Meyer. ("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 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. Respondent, age 43, resides in Dallas, Texas. Respondent was the founder and, during the period of the conduct described below, managing partner of Aldus Equity Partners. Respondent was also the managing partner of Aldus Capital, LLC, a registered investment adviser ("Aldus"). Respondent held a Series 65 license during the relevant period.

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, including Aldus, to Henry Morris and others.

3. On October 6, 2009, 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. Saul Meyer, Supreme Court Indictment No. 4755/09. In conjunction with his guilty plea, Meyer also agreed to forfeit $1 million. On December 5, 2012, a judgment in the criminal case was entered against Respondent, and he was sentenced to a three-year period of conditional discharge.

4. On May 22, 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, Section 17(a) of the Securities Act of 1933, and Sections 206(1) and (2) of the Advisers Act.

IV.

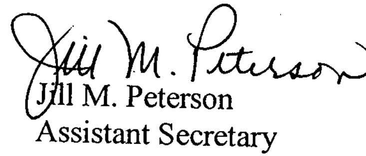
In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

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, or transfer agent, with the right to reapply for reentry after seven 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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 34-72367 / June 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15924

In the Matter of **LifeHealthCare, Inc.,** **Smartlinx, Inc., and** **Total Apparel Group, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. LifeHealthCare, Inc. (CIK No. 1440048) is a void Delaware corporation located in Westport, Connecticut with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). LifeHealthCare 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 $61,730 for the prior nine months. As of May 29, 2014, the company's stock (symbol "LFHE") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3). The Bank Holdings (CIK No. 1234383) is a

revoked Nevada corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g).

2. Smartlinx, Inc. (CIK No. 1341327) is a revoked Nevada corporation located in Union City, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Smartlinx is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended March 31, 2010, which reported a net loss of $286,989 for the prior twelve months. As of May 29, 2014, the company's stock (symbol "SMLK") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Total Apparel Group, Inc. (CIK No. 1475146) is a defaulted Nevada corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Total Apparel Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2010, which reported a net loss of over $3.43 million for the prior nine months. As of May 29, 2014, the company's stock (symbol "TLAG") 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

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

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

6. 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)].

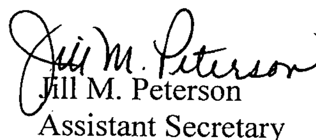
If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against 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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 11, 2014

In the Matter of

LifeHealthCare, Inc.,
Smartlinx, Inc., and
Total Apparel Group, Inc.,

File No. 500-1

ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of LifeHealthCare, Inc. because it has not filed any periodic reports since the period ended June 30, 2010.

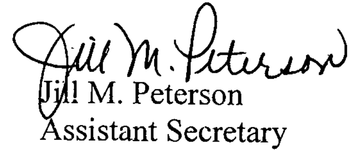
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Smartlinx, Inc. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Total Apparel Group, 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 June 11, 2014, through 11:59 p.m. EDT on June 24, 2014.

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. 72365 / June 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15923

In the Matter of The Bank Holdings, Community Valley Bancorp, Genemen, Inc., GWS Technologies, Inc., Homeland Precious Metals Corp., and NuRx Pharmaceuticals, Inc., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents The Bank Holdings, Community Valley Bancorp, Genemen, Inc., GWS Technologies, Inc., Homeland Precious Metals Corp., and NuRx Pharmaceuticals, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. The Bank Holdings (CIK No. 1234383) is a revoked Nevada corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). The Bank Holdings 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, 2009, which reported a net loss of over $45 million for the prior twelve months. As of May 29, 2014, the company's stock (symbol "TBHS") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC

Markets Group, Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Community Valley Bancorp (CIK No. 1170833) is a California corporation located in Chico, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Community Valley 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 over $5 million for the prior six months. As of May 29, 2014, the company's stock (symbol "CVLL") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Genemen, Inc. (CIK No. 1361951) is a revoked Nevada corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Genemen is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended February 28, 2010, which reported a net loss of $138,598 since the company's February 9, 2005 inception. As of May 29, 2014, the company's stock (symbol "GNMN") was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. GWS Technologies, Inc. (CIK No. 1365983) is a void Delaware corporation located in Scottsdale, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GWS Technologies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 31, 2010, which reported a net loss of over $1.3 million for the prior three months. As of May 29, 2014, the company's stock (symbol "GWSC") 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. Homeland Precious Metals Corp. (CIK No. 1289634) is an Alberta corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Homeland Precious Metals is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended March 31, 2010, which reported a net loss of $66,742 for the prior twelve months. As of May 29, 2014, the company's stock (symbol "HPMFF") was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. NuRx Pharmaceuticals, Inc. (CIK No. 1174228) 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). NuRx Pharmaceuticals 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 over $4.26 million for the prior nine months. As of May 29, 2014, the company's stock (symbol "NUXP") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

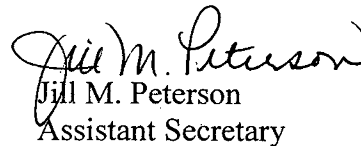
or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 11, 2014

In the Matter of **The Bank Holdings,** **Community Valley Bancorp,** **Genemen, Inc.,** **GWS Technologies, Inc.,** **Homeland Precious Metals Corp., and** **NuRx Pharmaceuticals, Inc.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of The Bank Holdings because it has not filed any periodic reports since the period ended December 31, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Community Valley Bancorp 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 Genemen, Inc. because it has not filed any periodic reports since the period ended February 28, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of GWS Technologies, Inc. because it has not filed any periodic reports since the period ended January 31, 2010.

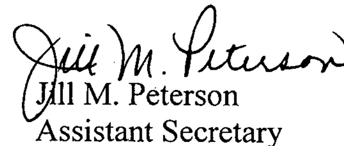
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Homeland Precious Metals Corp. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of NuRx Pharmaceuticals, Inc. because it has not filed any periodic reports since the period ended June 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 June 11, 2014, through 11:59 p.m. EDT on June 24, 2014.

By the Commission.



Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9599 / June 11, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72370 / June 11, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3854 / June 11, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31077 / June 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15926

In the Matter of

ROBERT C. ACRI

Respondent.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 4C, 15(b), AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND RULE 102(e)(1)(iii) OF THE COMMISSION'S RULES OF PRACTICE MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C, 15(b), and 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"), Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act"), and Rule 102(e)(1)(iii) of the Commission's Rules of Practice against Robert C. Acri ("Acri" 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 Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act, Sections 4C, 15(b), and 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, Section 9(b) of the Investment Company Act of 1940, and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of fraud by an investment adviser in connection with the offer and sale of promissory note securities. Between April and September 2011, Acri, as the controlling managing member of Commission-registered investment adviser Kenilworth Asset Management LLC ("Kenilworth"), defrauded Kenilworth's investment advisory clients in the offer and sale of $240,000 in promissory note securities of Prairie Common Holdings LLC ("Prairie"). Acri told clients that their funds would be used in the development of a retail parcel located near Hammond, Indiana, and that their investments would be secured by real estate. Acri, however, misappropriated $41,250 of the total proceeds, and the investments were never secured. Acri also failed to disclose material information to advisory clients concerning: (1) a conflict of interest arising from his motivation to engage in the offering to help other Kenilworth advisory clients recover on a prior, delinquent $500,000 loan to Praedium Development Corporation ("Praedium"), Prairie's developer; (2) the distressed financial condition of the real estate development project of which Prairie was a part, Praedium, and a Praedium principal; and (3) the five percent commission Kenilworth would receive on sales of the securities, which totaled $13,750. Based on these actions, Acri willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act.

---

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

Respondent

1. **Robert C. Acri** is 57 years old and a resident of Winnetka, Illinois. Acri was the founder, co-owner, and manager of Kenilworth Asset Management LLC, an investment adviser registered with the Commission. In July 2012, Acri resigned as a principal and his ownership of Kenilworth was terminated. Acri was also the founder and manager of the KAM Private Fund, LLC, a private pooled investment vehicle not registered with the Commission. From January 2010 through June 2011, Acri was also associated with a broker-dealer registered with the Commission. Acri is also an attorney licensed to practice in Illinois.

Other Relevant Entities

2. **Kenilworth Asset Management LLC**, an Illinois limited liability company formed on March 27, 2002, is an investment adviser registered with the Commission since February 25, 2011. Kenilworth's principal place of business is in Kenilworth, Illinois.

3. **KAM Private Fund, LLC** ("KAM Private Fund"), an Illinois limited liability company formed on November 23, 2004, was a private pooled investment vehicle not registered with the Commission. KAM Private Fund's principal place of business was in Kenilworth, Illinois, and although it was administratively dissolved by the State of Illinois on May 11, 2007, Acri continued to operate it until approximately June 2012.

4. **Praedium Development Corporation**, an Illinois corporation formed on December 30, 1998, is in the business of real estate development and is not registered with the Commission. Praedium's principal place of business is in Northbrook, Illinois.

5. **Woodmar Hammond, LLC** ("Woodmar"), an Illinois limited liability company affiliated with Praedium and formed on January 19, 2005, was formed to hold a real estate investment located near Hammond, Indiana, and is not registered with the Commission. Woodmar, whose principal place of business was in Northbrook, Illinois, was involuntarily dissolved on July 12, 2013.

6. **Prairie Common Holdings LLC**, an Illinois limited liability company affiliated with Praedium and formed on January 27, 2011, was formed to hold a real estate investment located near Hammond, Indiana, and is not registered with the Commission. Prairie's principal place of business is in Northbrook, Illinois.

Facts

7. In 2011, Acri controlled Kenilworth, a Commission-registered investment adviser. Acri, as Kenilworth's founder and one of its managing members, controlled its bank accounts, hired its employees, and made significant decisions concerning the investments it offered to its clients and its policies and practices.

8. In January 2005, Acri, as adviser to the KAM Private Fund in which several Kenilworth clients were or later became investors, invested $500,000 of the fund's assets in a one-year promissory note bearing 15% interest and issued by Praedium, a real estate development company controlled by Acri's friend ("the Praedium principal") and one other person. The purpose

of the Praedium note investment was to provide funds to Praedium for use with Woodmar, an entity created by Praedium to redevelop a retail shopping center near Hammond, Indiana.

9. As the Woodmar project struggled to move forward, Praedium failed to make any payments on its $500,000 promissory note issued to the KAM Private Fund. The economic and real estate downturn of 2008-09 further increased Praedium's/Woodmar's financial distress by making it difficult for Praedium/Woodmar to secure leases from prospective tenants and to obtain necessary financing, including the promised tax increment financing (TIF) from the City of Hammond upon which the economic viability of the project depended. As a result, Praedium/Woodmar became delinquent on a mortgage, the payment of its property taxes, and the payment to some of its contractors.

10. As a potential way forward, Praedium developed a plan wherein two smaller parcels would be separated from the Woodmar project and developed so as to create equity in the larger Woodmar project and demonstrate that progress was being made overall. To accomplish this plan, Praedium created two new companies, including Prairie Common Holdings, to own and develop the two smaller parcels.

11. Because Praedium required financing to advance the Prairie project but was unable to obtain it from banks and other traditional lenders, the Praedium principal turned to Acri for assistance in finding investors to supply the necessary funds.

12. In early 2011, Acri decided to raise funds for Prairie from Kenilworth's clients. One of Acri's primary purposes for selling Prairie promissory notes to Kenilworth clients was to give other Kenilworth clients (*i.e.*, those who had invested in the KAM Private Fund) a chance to recover on their earlier investment in Praedium.

13. Acri and the Praedium principal agreed that Kenilworth would receive a five percent commission on the sales of Prairie promissory notes.

14. From approximately April 2011 through September 2011, Acri and a Kenilworth associate offered and sold a total of $240,000 in Prairie promissory notes to six Kenilworth clients. Acri drafted these notes, which bore a 15% annual interest rate and stated maturities of approximately 6 to 8 months.

15. In his offer and sale of the Prairie promissory notes, Acri told Kenilworth clients that their funds would be used in the development of a retail parcel located near Hammond, Indiana.

16. In his offer and sale of the Prairie promissory notes, Acri knowingly failed to tell Kenilworth clients the following material facts:

- Kenilworth clients and others, through the KAM Private Fund, loaned $500,000 to Praedium for the development of Woodmar in 2005;
- the KAM Private Fund had not been paid anything by Praedium on this loan;

- that a primary purpose for the selling of the Prairie notes to Kenilworth clients was to give other Kenilworth clients (*i.e.*, those who had invested in the KAM Private Fund) a chance to recover on their earlier investment in Praedium;

- Praedium/Woodmar had been delinquent in the payment of its mortgage, property taxes, and some contractor invoices;

- Praedium was also the developer of the Prairie project;

- the Praedium principal was Acri's personal friend and was also having financial difficulties; and

- Kenilworth would receive a five percent commission on the sale of the Prairie notes.

17. In connection with the offer and sale of the Prairie notes, Acri also did not tell the Kenilworth associate about: the KAM Private Fund's delinquent loan to Praedium; the financial difficulties of Praedium/Woodmar; and that Kenilworth would receive a commission for selling the Prairie notes.

18. Acri misappropriated $41,250 of the Kenilworth clients' funds that were supposed to be used to develop Prairie. Specifically, Acri spent: $28,750 in repayment of other former and current clients and fund investors; $7,500 in partial payment of a settlement of a lawsuit against Acri; and $5,000 to pay a person to purportedly seek a loan for Praedium/Woodmar.

19. Kenilworth received $13,750 in commissions that Acri did not disclose to the Prairie investors. Acri controlled the use of those funds.

20. Acri also told investors that their investments in the Prairie notes would be secured by a security interest in real estate recorded by Praedium/Prairie. Acri took no action to ensure that such a recording occurred.

Violations

21. As a result of the conduct described above, Acri willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

22. As a result of the conduct described above, Acri willfully violated Sections 206(1) and 206(2) of the Advisers Act which prohibit fraudulent conduct by an investment adviser.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 4C, 15(b), and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, Section 9(b) of the Investment Company Act, and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, it is hereby ORDERED that:

A. Acri cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act.

B. Acri be, and hereby is:

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

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter;

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock; and

denied the privilege of appearing or practicing before the Commission as an attorney.

Any reapplication for association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization 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.

C. Acri shall, within 14 days of the entry of this Order, pay disgorgement of $55,000.00, prejudgment interest of $4,478.96, and a civil money penalty in the amount of $55,000.00 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and/or 31 U.S.C. 3717, as applicable. Payment must be made in one of the following ways:

(1) Acri 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) Acri 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 Robert C. Acri as the 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: James A. Davidson, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604.

The Commission will hold funds paid in this proceeding pending a decision whether the Commission, in its discretion, will seek to distribute funds or transfer them to the United States Treasury.

The Commission may distribute civil money penalties collected in this proceeding if, in its discretion, the Commission orders the establishment of a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Acri 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 Acri's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a

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Penalty Offset, Acri 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 Acri 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

Commissioner Aguilar
Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3855 / June 11, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31078 / June 11, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15927

In the Matter of

THOMAS E. MEADE

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, 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, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(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 Thomas E. Meade ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940,

Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. Private Capital Management, Inc. ("PCM, Inc."),[2] formerly a registered investment adviser based in Denver, Colorado, failed to prevent, detect or respond to insider trading by a former PCM, Inc. Vice President, Drew Peterson ("Peterson") in 2010. Meade was the President and Chief Compliance Officer ("CCO") for PCM, Inc. during the period of January 1, 2009 through July 31, 2012 (the "Relevant Period"). Meade was aware of the unique risks for misuse of material non-public information by Peterson due to Meade's personal relationship with Peterson's father, who served on the board of at least one public company. Yet, Meade failed to design PCM, Inc.'s written compliance policies and procedures ("Policies and Procedures") in light of these insider trading risks associated with PCM, Inc.'s particular operations. Additionally, Meade failed to adequately collect and review records of personal trading by PCM, Inc. employees during the Relevant Period. Furthermore, Meade failed to maintain restricted or watch lists of stocks as required under PCM, Inc.'s Policies and Procedures. Even after learning of Peterson's insider trading, Meade failed to conduct any investigation of the trading as required by PCM, Inc.'s Policies and Procedures or document violations of PCM, Inc.'s Code of Ethics. Lastly, as CCO, Meade was responsible for administering PCM, Inc.'s Policies and Procedures, yet he overly relied on employees to self-report violations and failed to annually assess the adequacy or effectiveness of PCM, Inc.'s Policies and Procedures that were in place.

Respondent

2. Meade, 73, of Denver, Colorado, was the President and CCO of PCM, Inc., an investment adviser registered with the Commission from at least March 23, 2001 until January 22, 2013. Meade is currently President of Private Capital Management, LLC, a wholly owned subsidiary of Guaranty Bank.

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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] Guaranty Bank and Trust Company ("Guaranty Bank") acquired substantially all of PCM, Inc.'s assets pursuant to a July 2012 Asset Purchase Agreement. PCM, Inc. is no longer an investment adviser and exists under the new name Meade Investments, Inc. solely to receive earn-out payments from a July 2012 Asset Purchase Agreement. Private Capital Management, LLC, a subsidiary of Guaranty Bank, currently manages the assets of PCM, Inc.'s former clients. The events described herein apply solely to PCM, Inc. and not to Private Capital Management, LLC.

Other Relevant Entity and Individual

3. PCM, Inc. was a Colorado corporation formerly headquartered in Denver, Colorado. PCM, Inc. was an investment adviser registered with the Commission from at least March 23, 2001 until January 22, 2013. PCM, Inc., with a staff of four to five people, provided investment advisory services focused on no-load mutual funds to more than 300 accounts and managed more than $150 million in assets. PCM, Inc. ceased advisory operations on July 31, 2012 and filed its Form ADV-W with the Commission on January 22, 2013.

4. Peterson is a Denver resident and former Vice President at PCM, Inc. While working for PCM, Inc., Peterson made securities recommendations to PCM, Inc. clients and provided investment advice on behalf of PCM, Inc.

Background

5. In April 2010, Peterson engaged in insider trading in Mariner Energy Inc. ("Mariner"), a publicly traded company. Peterson received a tip from his father, who served on the Board of Directors of Mariner as the Chairman of the Audit Committee at that time, about the pending acquisition of Mariner by another company. On the basis of this information, Peterson traded in his own accounts and also invested in Mariner on behalf of a number of PCM, Inc. clients. Peterson resigned from PCM, Inc. in August 2010.

6. In August 2011, the Commission filed a civil complaint that alleged Peterson and his father engaged in insider trading in Mariner. (SEC v. H. Clayton and Drew Clayton Peterson, No. 11-CIV-5448 (S.D.N.Y. 2011)). In the following months, the Commission amended the complaint to include a hedge fund manager who was a close friend of Peterson's, which was then followed by a criminal complaint against all three defendants. (US v. H. Clayton Peterson, 11-cr-665 (S.D.N.Y. 2011)). All three defendants pled guilty and were convicted.

7. In August 2010, the Commission's Office of Compliance Inspections and Examinations ("OCIE") conducted a cause examination of PCM, Inc. out of concerns that Peterson's trading and dissemination of material, non-public information had gone undetected ("2010 Examination"). The findings of that exam resulted in a referral to the Division of Enforcement that in turn led to these proceedings.

PCM, Inc., through Meade, Failed to Collect, Review and Maintain Reports of Personal Securities Transactions

8. Section 204A of the Advisers Act mandates that every registered investment adviser subject to Section 204 of the Advisers Act "shall establish, maintain, and enforce written policies and procedures reasonably designed...to prevent the misuse in violation of this Act or the Securities Exchange Act of 1934, or the rules and regulations thereunder, of material, nonpublic information by such investment adviser or any person associated with such investment adviser." Rule 204A-1, promulgated under Section 204A, requires registered investment advisers to "establish, maintain and enforce a written code of ethics that, at a minimum" requires access

persons[3] who have beneficial ownership of securities to submit annual holdings reports and quarterly securities transaction reports. Rule 204-2(a)(13) under the Advisers Act requires registered investment advisers to maintain these reports.

9. PCM, Inc.'s Policies and Procedures tracked much of the language in the Advisers Act as well as the language of Rule 204A-1 thereunder, and provided templates for use by employees to complete their annual holdings and quarterly securities transaction reports. PCM, Inc.'s Policies and Procedures required that Meade, as PCM, Inc.'s CCO, collect and review these reports. Sometime prior to January 1, 2009, PCM, Inc. stopped requiring employees to submit their own reports using the templates and instead relied upon Meade's review of an online application called "Portfolio Center" to fulfill the reporting requirements. This change was never reflected in PCM, Inc.'s Policies and Procedures.

10. Portfolio Center contained much of the information used to populate brokerage statements, including date of transaction, ticker symbol, number of shares, nature of the transaction, the price of the security at which the transaction was effected and the principal amount of the transaction. The information provided by Portfolio Center may have been sufficient to meet an exception for the quarterly securities transaction reporting requirement set forth in Rule 204A-1(b)(3) under the Advisers Act, however no such exception exists for the annual holdings reporting requirement.[4]

11. Meade failed to collect *any* of the required reports for an investment club account run by Peterson, known as Blind Seven, LLC.[5] Rule 204A-1(e)(3) under the Advisers Act defines "beneficial ownership" the same as 17 C.F.R. 240.16a-1(a)(2), which, among other things, includes

[3] The term "access person" is defined in Rule 204A-1(e)(1) under the Advisers Act as any "supervised person" (broadly defined under Section 202(a)(25) of the Advisers Act as any employee who provides investment advice on behalf of the investment adviser) who: (1) has access to nonpublic information regarding clients' purchase or sale of securities; (2) is involved in making securities recommendations to clients; or (3) has access to nonpublic securities recommendations. Directors, officers and partners (and any other person occupying a similar status or performing similar functions) are presumed to be access persons if the company's primary business is providing investment advice. PCM, Inc.'s policies and procedures expanded the reporting requirements to include "all individuals associated with PCM, Inc."

[4] According to Rule 204A-1(b)(2)(i)(A)-(E) under the Advisers Act, quarterly securities transaction reports must contain five different pieces of information about each transaction involving a reportable security in which an access person acquires a direct or indirect beneficial ownership interest: (1) the date of the transaction, the title, and as applicable the exchange ticker symbol or CUSIP number, interest rate and maturity date, number of shares, and principal amount of each reportable security; (2) the nature of the transaction (purchase, sale, etc.); (3) the price of the security at which the transaction was effected; (4) the name of the broker, dealer or bank with or through which the transaction was effected; and (5) the date the access person submitted the report. As set forth above, the information in Portfolio Center covered this information. According to Rule 204A-1(b)(3) under the Advisers Act, a code of ethics need not require an access person to provide a quarterly securities transaction report if "the report would duplicate information contained in...account statements that you hold in your records..."

[5] Blind Seven, LLC ("Blind Seven") is an investment club founded in 1999 by Peterson and some of his friends for the purpose of making joint investments. At all relevant times, Peterson was a beneficial owner of securities in the Blind Seven account and exercised control over the entity's investment decisions. Peterson also maintained a separate personal brokerage account that Meade was able to access through Portfolio Center.

situations where a person had a direct pecuniary interest in equity securities, with an opportunity to profit or share in any profit derived from a transaction in the account. Peterson shared in the profits derived from transactions in the account, and thus was a beneficial owner under Rule 204A-1(e)(3) under the Advisers Act. Meade knew that Peterson was a beneficial owner of securities in this account and that it was not accessible through Portfolio Center, yet he did not require Peterson to submit any of the required reports or records. Meade's failure to collect the required reports for transactions and holdings in Peterson's Blind Seven account made it impossible for him to perform the required review of Peterson's transactions.

12. Furthermore, Meade consistently failed to adequately review transactions by other PCM, Inc. employees, even though he could access the accounts through Portfolio Center. Prior to May 2011, PCM, Inc.'s Policies and Procedures did not include a provision requiring the review of employee's personal securities transactions or holdings. For this period, Meade failed to adequately review the transactions on Portfolio Center, and instead relied a practice of reviewing transactions arbitrarily, doing cursory scans of the accounts on an irregular basis.

13. Following the 2010 Examination, OCIE cited PCM, Inc.'s lack of written procedures requiring a review of employee transactions and the lack of a formal process for such review as a weakness in PCM's compliance program in a deficiency letter dated April 21, 2011 ("Deficiency Letter"). PCM, Inc.'s response to the Deficiency Letter provided amended Policies and Procedures that included a provision requiring Meade to "review as needed and at least quarterly all [Holding] Reports and Quarterly Securities Transactions Reports or monthly statements and trade confirmations." PCM, Inc.'s response went on to claim that, notwithstanding the previous absence of procedures, the firm had in fact conducted the required review.

14. Contrary to PCM, Inc.'s response to the Deficiency Letter, Meade failed to comply with the amended Policies and Procedures. Rather, Meade continued his arbitrary practice of conducting cursory reviews of employee transactions on Portfolio Center on an irregular basis.

Meade Failed to Maintain Restricted and Watch Lists of Securities as Required by PCM, Inc.'s Insider Trading Policy

15. PCM, Inc.'s Insider Trading Policy, established in accordance with Sections 204A of the Advisers Act and Rule 204A-1 thereunder, mandated that Meade, as PCM, Inc.'s President, maintain Restricted and Watch Lists of "securities regarding which PCM, Inc. or its associated persons may have material, non-public information." The Insider Trading Policy banned trading in any security on the Restricted List and required Meade to watch for "suspicious trading activity" in any security on the Watch List.

16. Peterson's father, who was also a close friend of Meade's, served as the Chairman of Mariner's Audit Committee from 2006 until 2010. Both Peterson and Meade were in regular contact with Peterson's father and sometimes discussed his work with Mariner. Despite the low threshold for placing a security on PCM, Inc.'s Watch List, described as a situation where "PCM, Inc. *may* come into possession of inside information," (*emphasis added*) Meade never placed

Mariner on either the Watch or Restricted List. In fact, Meade never placed any security on the Watch or Restricted Lists.

17. PCM, Inc.'s Policies and Procedures, as established, maintained and enforced, failed to adequately address the risks associated with personal trading activities of supervised persons. For example, until 2011 there was no requirement for PCM, Inc. to review securities transactions or holdings of its employees.

Meade Failed to Investigate Suspicious Trading as Required by PCM, Inc.'s Insider Trading Policy

18. PCM, Inc.'s Insider Trading Policy also required Meade, as PCM, Inc.'s President, to identify, monitor and investigate any suspicious trading activity by PCM, Inc. or its employees. Additionally, PCM, Inc.'s Policies and Procedures required that Meade ensure PCM, Inc. made and kept all records of any violation of company's Code of Ethics.

19. In April 2010, Peterson traded in Mariner days before a merger announcement that drove the stock price up. Peterson traded in both the Blind Seven account and his personal brokerage account. Peterson also traded in Mariner for a number of PCM, Inc. clients at the same time. Meade may not have been aware of Peterson's trades in the Blind Seven account due to his failure to collect the required reports as described earlier, but he had access to Peterson's personal account through Portfolio Center as well as access to the PCM, Inc. client investments. PCM, Inc.'s Insider Trading Policy required Meade to investigate any suspicious trading and document any investigation into potential insider trading. Yet Meade failed to investigate the Mariner trades in Peterson's Portfolio Center account and in a number of PCM, Inc.'s client accounts placed at the same time, days before the merger announcement. These trades should have raised a red flag given not only the timing but also PCM, Inc.'s focus on investing client assets in no-load mutual funds. During the Commission's investigation, Meade acknowledged that the timing of these trades was suspicious, yet he failed to conduct any investigation of the trading.

20. After failing to conduct an investigation of suspicious trading following the merger announcement, Meade also failed to conduct or document any investigation following: (1) the August 2011 complaint filed by the Commission alleging insider trading by Peterson and his father; (2) the October 2011 amended complaint adding a close friend of Peterson's as a co-defendant; and (3) the July 2012 announcement that all of the defendants had settled. Although Meade did consult with counsel during the 2010 Examination, Meade did not take steps, directly or with the assistance of counsel, to comply with the requirement in PCM, Inc.'s Insider Trading Policy to investigate Peterson's trades or document the investigation. Even if Meade believed that Peterson's departure from PCM, Inc. or the ongoing federal investigations absolved his duty to investigate Peterson's trades, it no way addressed the possibility that Peterson had tipped other PCM, Inc. employees or clients.

Meade Failed to Annually Assess the Adequacy or Effectiveness of PCM, Inc.'s Policies and Procedures and Failed to Address PCM, Inc.'s Unique Insider Trading Risk

21. Rule 206(4)-7 under the Advisers Act, often called the "Compliance Rule," requires Commission-registered advisers to: (1) "[a]dopt and implement written policies and procedures reasonably designed to prevent violation" of the Advisers Act and the Rules thereunder by the adviser and its supervised persons; (2) review at least annually the "adequacy of the policies and procedures" and the "effectiveness of their implementation;" and (3) designate a CCO, who is a supervised person, who is "responsible for administering the policies and procedures."

22. Meade did not assess the adequacy or effectiveness of PCM, Inc.'s Policies and Procedures as required annually by Rule 206(4)-7. Meade confirmed that PCM, Inc.'s Policies have been updated only two times since PCM, Inc.'s counsel initially drafted the policies: (1) in response to OCIE's 2002 Examination recommending PCM, Inc. adopt an Insider Trading Policy; and (2) in response to OCIE's 2010 Examination as highlighted above. Furthermore, PCM, Inc.'s Policies and Procedures included outdated references to rules and regulatory frameworks that had been altered or eliminated several years earlier. While Meade did complete annual certifications attesting to a review of the policies, he did not take any steps to assess how such policies actually operated in the context of PCM, Inc.'s business.

23. PCM, Inc.'s Policies and Procedures failed to adequately address the risks associated with personal trading activities of supervised persons, particularly the unique risks for insider trading that it faced given the close relationship of Meade and Peterson with Peterson's father, who served on the board of at least one public company. Meade was aware of the unique conflicts and risks to PCM, Inc. posed by these relationships yet took no action to address them through PCM, Inc.'s Policies and Procedures.

24. According to PCM, Inc.'s Policies and Procedures, Meade was PCM, Inc.'s President, CCO, majority owner and the designated supervisor of all PCM, Inc. staff during the Relevant Period. As a result, Meade was responsible for administering PCM, Inc.'s Policies and Procedures. However, Meade did not train his employees regarding PCM, Inc.'s Policies and Procedures and instead relied on his employees to review the Policies and Procedures on their own and self-report violations.

Violations

25. As a result of the conduct described above, PCM, Inc. willfully[6] violated, and Meade willfully aided and abetted and caused PCM, Inc.'s violations of, Section 204A of the Advisers Act and Rule 204A-1 thereunder, which requires that a registered investment adviser establish, maintain and enforce a written code of ethics that includes: (1) a standard of business conduct reflecting the adviser's and its supervised persons' fiduciary obligations; (2) the requirement that all staff comply with the federal securities laws; and (3) requirements that access

[6] 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)).

persons submit for review a securities transaction report on a quarterly basis and a securities holdings report upon hiring and then at least annually thereafter and that the investment adviser review these reports periodically.

26. As a result of the conduct described above, PCM, Inc. willfully violated and Meade willfully aided and abetted and caused PCM's violations of 204(a) of the Advisers Act and Rules 204-2(a)(12-13) thereunder, which require that investment advisers registered with the Commission maintain and preserve certain books and records. Rule 204-2(a)(12)(ii) requires that registered investment advisers "make and keep true, accurate and current...a record of any violation of the code of ethics, and of any action taken as a result of the violation." Rule 204-2(a)(13) requires that registered investment advisers "make and keep true, accurate and current...a record of each report made by an access person as required by Section 275.204A-1(b)....".

27. As a result of the conduct described above, PCM, Inc. willfully violated, and Meade willfully aided and abetted and caused PCM's violations of, Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires that a registered investment adviser: (1) adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules; (2) review at least annually its written policies and procedures and the effectiveness of their implementation; and (3) designate a Chief Compliance Officer responsible for administering the policies and procedures.

28. As a result of the conduct described above, Meade failed to reasonably supervise Peterson within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing violations of the Advisers Act and rules thereunder. A safe harbor exists if there are "established procedures, and a system for applying such procedures" that would be expected to "prevent and detect the violation" and such person has reasonably discharged the duties and obligations upon him without "reasonable cause" to believe such procedures were not being complied with. Given the pervasiveness of PCM, Inc.'s failure to comply with Advisers Act Rules and its own Policies, Meade could not have had "reasonable cause" to believe that PCM, Inc. was in a position to prevent and detect Peterson's violations."

Undertakings

29. Respondent undertakes to:

a. Within thirty (30) days of the entry of the Order, provide a copy of this Order to each of PCM, Inc.'s former and Private Capital Management, LLC's current advisory clients who were clients at any time between January 1, 2010 and May 31, 2014 – via mail, electronic mail, or such other method as may be acceptable to the Commission's staff, together with a cover letter in a form not unacceptable to the Commission's staff; and

b. Certify, in writing, compliance with the undertaking set forth above. The certification shall identify the undertaking, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Jay Scoggins, Assistant Director, Denver Regional Office, Division of Enforcement, Securities and Exchange Commission, 1801 California Street, Suite 1500, Denver, CO 80202, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

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

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Meade shall cease and desist from committing or causing any violations and any future violations of Sections 204, 204A, and 206(4) of the Advisers Act and Rules 204-2, 204A-1 and 206(4)-7 promulgated thereunder.

B. Respondent Meade be, and hereby is:

Pursuant to Section 203(f) of the Advisers Act, barred from associating in a compliance capacity and supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 9(b) the Investment Company Act, 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.

Any reapplication for association in these capacities 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.

C. Respondent Meade is censured.

D. Respondent Meade shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $100,000.00 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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 Thomas E. Meade 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 K. Lutz, Regional Director, Denver Regional Office, Division of Enforcement, Securities and Exchange Commission, 1801 California Street, Suite 1500, Denver, CO 80202.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent

provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement and pre-judgment interest. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement and interest should not be ordered; (3) contest the amount of disgorgement and interest to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

F. Respondent shall comply with the undertakings enumerated in Section III, Paragraph 28 above.

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. 72380 / June 12, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15929

In the Matter of LARRY R. POLHILL, 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 Larry R. Polhill ("Respondent").

II.

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

III.

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

1. Polhill was the president and co-owner of American Pacific Financial Corporation ("APFC") from at least the early 1980s through 2010. At all relevant times, Polhill controlled APFC. From 1984 through 1989, Polhill was also associated with Delta Investment Securities Corporation, a registered broker-dealer, as its owner and operator. Polhill has not been associated with a registered broker-dealer since 1989. Polhill, 62 years old, is a resident of Phoenix, Arizona.

2. On October 1, 2013, a final judgment was entered by consent against Polhill, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Larry R. Polhill, Civil Action Number 5:13-cv-01729-PA-SP, in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, in connection with the sale of promissory notes between the mid-1980s and 2008, Polhill falsely stated to investors that their notes were secured by specific collateral when, in fact, the notes were unsecured, and the collateral had sometimes been previously pledged to senior lenders or was otherwise insufficient to secure investor loans. The complaint also alleged that Polhill sold unregistered securities.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Polhill be, and hereby is:

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

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

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31082 / June 16, 2014

In the Matter of

CREDIT SUISSE ASSET MANAGEMENT, LLC
CREDIT SUISSE ASSET MANAGEMENT LIMITED
CREDIT SUISSE HEDGING-GRIFFO SERVICOS INTERNACIONAIS S.A.
CREDIT SUISSE AG
CREDIT SUISSE GROUP AG

c/o Credit Suisse Asset Management, LLC
One Madison Avenue
New York, NY 10010

CREDIT SUISSE SECURITIES (USA) LLC

Eleven Madison Avenue
New York, NY 10010

(812-14313)

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

Credit Suisse Asset Management, LLC, Credit Suisse Asset Management Limited, Credit Suisse Hedging-Griffo Servicos Internacionais S.A., Credit Suisse Securities (USA) LLC, Credit Suisse AG ("CSAG") (collectively, "Applicants"), and Credit Suisse Group AG (solely with respect to a condition as noted in the application), filed an application on May 19, 2014, with a filing date of May 20, 2014, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which CSAG is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the Act with respect to a guilty plea entered on May 19, 2014, by CSAG in the United States District Court for the Eastern District of Virginia.

On May 19, 2014, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 31051) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

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

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations and conditions contained in the application filed by Credit Suisse Asset Management, LLC, et al. (File No. 812-14313) that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of a guilty plea, described in the application, entered by CSAG in the United States District Court for the Eastern District of Virginia on May 19, 2014.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72393 / June 16, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3857 / June 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15930

In the Matter of PARADIGM CAPITAL MANAGEMENT, INC. and CANDACE KING WEIR, Respondents.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Paradigm Capital Management, Inc. ("Paradigm") and Candace King Weir (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 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(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

SUMMARY

1. These proceedings involve retaliation against a Dodd-Frank whistleblower who reported certain trading activity revealing that Candace King Weir ("Weir") caused her affiliated investment adviser Paradigm Capital Management, Inc. ("Paradigm") to engage in principal transactions with C.L. King & Associates, Inc. ("C.L. King"), an affiliated broker-dealer owned by Weir, without providing effective disclosure to, or obtaining effective consent from, PCM Partners L.P. II ("the Fund"), a hedge fund client advised by Paradigm. Upon learning that the whistleblower reported potential securities law violations to the Commission, Paradigm engaged in a series of retaliatory actions that ultimately resulted in the whistleblower's resignation.

2. Weir is the majority owner of Paradigm, an investment adviser registered with the Commission. She exercises ultimate control and decision-making authority over Paradigm. Weir also controls and is the majority owner of C.L. King, a broker-dealer registered with the Commission.

3. From at least 2009 through 2011, Weir caused the Fund to engage in a trading strategy to reduce the tax liability of the Fund's investors. As part of that trading strategy, Weir, as a portfolio manager for the Fund, directed Paradigm's traders to sell selected securities at prevailing market prices from the Fund to a proprietary trading account ("Trading Account 1") she controlled at her affiliated broker-dealer C.L. King. These sales were executed to realize trading losses for tax deduction purposes. Because Weir controlled both Paradigm and C.L. King, the transactions between the two entities were principal transactions that required written disclosure to, and consent from, the Fund. Paradigm, however, did not provide effective written disclosure to the Fund and failed effectively to obtain the Fund's consent to the transactions. Paradigm established a review committee to approve the pricing of the trades in an attempt to satisfy the requirements of Section 206(3) of the Advisers Act, but the committee was conflicted.

4. By engaging in these principal transactions without providing effective disclosure to, and obtaining effective consent from, the Fund, Paradigm violated, and Weir caused violations of, Section 206(3) of the Advisers Act. In addition, Paradigm's Form ADV omitted to state material facts concerning Paradigm's process for obtaining consent to the principal transactions.

RESPONDENTS

5. **Paradigm Capital Management, Inc. ("Paradigm")** is a New York corporation headquartered in Albany, New York. Paradigm also has offices in New York, New York. Paradigm is a wholly owned subsidiary of Paradigm Capital Holdings, Inc. Paradigm has been registered with the Commission as an investment adviser since 1994 and advises affiliated hedge funds including, among others, PCM Partners L.P. II. Paradigm has total assets under management of approximately $1.7 billion. Candace King Weir owns 73% of Paradigm and has ultimate control of and decision-making authority for Paradigm.

6. **Candace King Weir ("Weir")** is the founder, Director, President, Chief Investment Officer, and a Portfolio Manager of Paradigm Capital Management, Inc. She is also the founder, Director, Chief Executive Officer, and President of C.L. King & Associates, Inc. Weir holds Series 7, 24, 53, and 63 securities licenses.

RELEVANT ENTITIES

7. **C.L. King & Associates, Inc. ("C.L. King")** is a New York corporation located in Albany, New York. C.L. King is a broker-dealer that has been registered with the Commission since 1972. Candace King Weir owns approximately 73% of C.L. King. C.L. King is the prime broker to PCM Partners L.P. II.

8. **PCM Partners L.P. II** is a Delaware limited partnership formed in June 2002. PCM Partners L.P. II is advised by Paradigm and has total assets of approximately $275 million.

9. **PCM Ventures II LLC** is a New York limited liability company. PCM Ventures II LLC is the general partner of PCM Partners L.P. II. Weir owns approximately 99% of PCM Ventures II LLC.

FACTS

Prohibited Principal Transactions

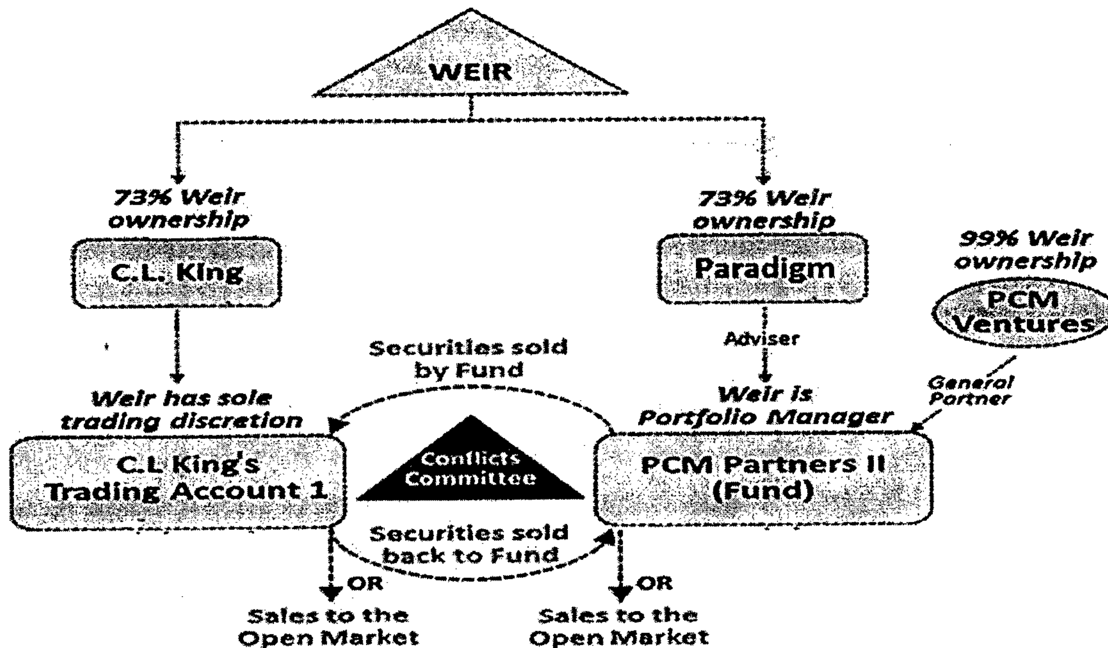
10. From at least 2009 through 2011, Paradigm sought to reduce the tax liability of the Fund's investors by selling securities that had unrealized losses to the open market or to C.L. King Trading Account 1. These realized trading losses were used to offset the Fund's realized gains.

11. When deciding whether to sell securities to the open market or to Trading Account 1, Weir, in her role as portfolio manager for the Fund, considered her views of the security, the need for efficient execution, and available cash positions. If Weir thought she might like to repurchase the security later for the Fund because she had a favorable view of the security and if it made execution more efficient, Weir would instruct Paradigm's traders to sell the security to Trading Account 1.

12. When selling securities to Trading Account 1, Paradigm's traders used C.L. King's trading systems and generally crossed a large block of shares from the Fund to Trading Account 1. These trades were effected at the prevailing market price and C.L. King did not charge a markup or commission on the transactions.

13. Between 2009 and 2011, Paradigm engaged in at least 83 principal transactions with C.L. King. Paradigm sold 47 securities positions from the Fund to Trading Account 1, and then repurchased 36 of those positions for the Fund.

The following diagram highlights the flow of the principal transactions and Weir's ownership interests in the relevant entities:



The Conflicts Committee

14. Because Weir controlled both Paradigm and C.L. King, all of the transactions between the Fund and Trading Account 1 were principal transactions that required Paradigm (i) to provide the Fund with written disclosure of the transactions prior to the transactions' completion, and (ii) to obtain the Fund's consent to engage in the transactions.

15. Weir, however, owned and controlled the Fund's general partner, PCM Ventures II LLC ("the General Partner"). She also shared in the trading profits and losses resulting from the principal transactions through her ownership in C.L. King. Accordingly, any written disclosure to her as the owner of the General Partner was insufficient, and for the same reason she also could not provide effective consent to the principal transactions.

16. Further, the Fund did not have a board of directors that could receive written disclosure of, and provide consent for, the principal transactions. In an attempt to satisfy the

written disclosure and consent requirements, Paradigm established a Conflicts Committee to review and approve each principal transaction on behalf of the Fund. The Committee consisted of two people: Paradigm's Chief Compliance Officer ("CCO") and Chief Financial Officer ("CFO"). Paradigm's CFO reported directly to Weir and Paradigm's CCO reported to Paradigm's board of directors, including Weir.

Conflicts Committee Was Conflicted

17. Paradigm's CFO also served as C.L. King's CFO. As the CFO of both Paradigm and C.L. King, his presence on the Conflicts Committee created a conflict in the principal transaction approval process.

18. Specifically, each time that C.L. King Trading Account 1 purchased securities from the Fund there was a negative impact on C.L. King's net capital. The CFO was evaluating the principal transactions and acting on behalf of the Fund as a member of the Conflicts Committee, while at the same time monitoring the principal transactions' impact on C.L. King's net capital as its CFO. This placed him in a conflict situation.

19. The CFO's conflict was highlighted in early 2012 when C.L. King's net capital declined in part as a result of Trading Account 1 purchasing large blocks of securities from the Fund in late 2011. To improve C.L. King's net capital position, the CFO suggested that C.L. King begin selling securities worth more than $20 million held in Trading Account 1 either to the open market or back to the Fund. He also suggested staggering future sales of securities from the Fund to Trading Account 1 for the benefit of C.L. King's net capital. The CFO's obligation to monitor C.L. King's net capital requirements was in conflict with his obligation to act in the best interests of the Fund as a member of the Conflicts Committee.

20. Because Weir had a personal interest in the principal transactions through her ownership of C.L. King and the Conflicts Committee was conflicted, Paradigm failed to provide effective written disclosure to the Fund and failed effectively to obtain the Fund's consent to the principal transactions.

21. As part of its fee structure, Paradigm charged the Fund an administrative fee for, among other things, compliance-related expenses, including the Conflicts Committee's administration of the principal transactions and complying with the written disclosure and consent requirements of Advisers Act Section 206(3).

Paradigm's Form ADV Omitted Material Facts

22. In discussing the Conflicts Committee, Paradigm's Form ADV Part 2A stated that the Conflicts Committee acts on behalf of the Fund when approving principal transactions. The Form ADV failed to disclose the CFO's conflict as a member of the Conflicts Committee, namely that as CFO of C.L. King, he was also responsible for monitoring the principal transactions' impact on C.L. King's net capital. By omitting this fact in discussing the Conflicts Committee, the Form ADV discussion of the Conflicts Committee was materially misleading.

Whistleblower Retaliation

23. On March 28, 2012, Paradigm's then-head trader ("Whistleblower") voluntarily made a whistleblower submission to the Commission that revealed the principal transactions discussed herein. The Whistleblower had been Paradigm's head trader since 2009.

24. Between March 28, 2012 and July 15, 2012, the Whistleblower, who had not yet disclosed to Paradigm his submission to the Commission, remained in his position as Paradigm's head trader. His duties and responsibilities were unchanged. He continued to execute orders and to supervise another Paradigm trader.

25. On July 16, 2012, the Whistleblower notified Weir and C.L. King's Chief Operating Officer that he had reported potential securities law violations to the Commission and identified the general conduct referenced in his submission to the Commission.

26. That day, the Whistleblower was questioned about his allegations and then returned to the trading desk and continued trading for the remainder of the day. At that time Paradigm retained outside counsel to advise the firm.

27. At the end of the day on July 17, the day after he revealed himself as a whistleblower, Paradigm informed the Whistleblower that he would be removed from Paradigm's trading desk and temporarily relieved him of his day-to-day trading and supervisory responsibilities. Paradigm informed him that, because he executed trades that were reported to the Commission, Paradigm needed to investigate his actions. Paradigm further directed the Whistleblower to work offsite at a different office building and instructed him to prepare a report that would detail all of the facts that supported the potential violations he reported to the Commission.

28. On July 17, the Whistleblower's employment counsel proposed that the Whistleblower be permitted to prepare his report from home rather than come into the office, which Paradigm allowed him to do. Paradigm and the Whistleblower's counsel also discussed the idea of the Whistleblower leaving the firm in exchange for a severance payment.

29. Between July 18 and July 20, Paradigm, on the advice of counsel, denied the Whistleblower access to certain Paradigm trading and account systems while he was at home. He previously had access to these Paradigm systems. Paradigm also denied the Whistleblower access to his existing email account and redirected the Whistleblower's trading and email accounts to its other trader so that he could continue receiving orders and making trades. Paradigm provided the Whistleblower with a new email address for the purpose of communicating internally and externally as necessary to complete his report. The Whistleblower worked remotely from home preparing the requested report and submitted it on Friday, July 20. On that same day, the Whistleblower notified Paradigm that he intended to return to work on Monday, July 23.

30. On July 21, Paradigm told the Whistleblower not to report to work on Monday, July 23, because Paradigm was continuing to evaluate the situation. The Whistleblower remained at home, and his salary and benefits remained the same.

31. On July 24, Paradigm informed the Whistleblower's employment counsel that the employment relationship between Paradigm and the Whistleblower was "irreparably damaged" and that Paradigm wanted to cooperate with the Whistleblower in his leaving employment with "as little difficulty or acrimony as possible."

32. After it became apparent that Paradigm and the Whistleblower were unable to agree on severance terms that would result in the Whistleblower's resignation or termination, the Whistleblower informed Paradigm that he was prepared to return to work, but only in continuation of his role as Paradigm's head trader.

33. On August 8, Paradigm requested that the Whistleblower return to work on August 13. Paradigm notified him that his compensation structure would remain the same and that he would be paid the same amount that he was paid as head trader. There was no indication by Paradigm, however, that he would return as head trader and resume the duties and responsibilities that accompany that position, including supervising another trader. Paradigm refused to specify his duties and merely noted that they would be "meaningful" to Paradigm.

34. In response, the Whistleblower again emphasized that he was prepared to return to work but that he intended to return to his position as Paradigm's head trader. Paradigm at that point made clear that the Whistleblower would not return to his position as head trader until Paradigm's investigation was complete. In the interim, Paradigm informed the Whistleblower that he would be asked to perform tasks that were "meaningful and, to some extent, parallel or overlap those of head trader" and that "[it] need not explain further."

35. Despite Paradigm's refusal to allow the Whistleblower to return as head trader, the Whistleblower returned to work as requested on August 13. Upon his return, he was no longer located on the trading desk and was placed instead in an office on a different floor. Paradigm informed the Whistleblower that his first assignment and top priority was to identify any potential wrongdoing by the firm so that it could further investigate his allegations.

36. As part of that assignment, the Whistleblower was asked to review more than 1,900 pages of hard-copy trading data, sorted by security. The Whistleblower suggested that, rather than reviewing 1,900 pages of trading data, specific reports could be generated in an electronic format that isolate the specific trades that were potentially violative. He requested that he be provided access to Paradigm's trading system so that he could generate the reports. Paradigm, after consulting with counsel, denied his request. The Whistleblower also suggested that someone else within Paradigm generate the reports, and while Paradigm agreed to this suggestion, it then informed him that it could not identify the reports based on the Whistleblower's description. Notwithstanding Paradigm's claim that it was a top priority for the Whistleblower to identify potentially violative trades and that the Whistleblower informed Paradigm that he believed there was a more efficient method for doing so, Paradigm insisted that

the Whistleblower review hard copy documentation of trades and refused to provide him with access to the reports he requested.

37. Paradigm maintained that the Whistleblower could not return to the trading desk because Paradigm needed the Whistleblower's top priority to be identifying specific conduct that could substantiate his claims of wrongdoing. Nonetheless, on August 15, in response to the Whistleblower's allegations that the firm's trading-related compliance policies were deficient, Paradigm tasked the Whistleblower with the additional task of consolidating multiple trading procedure manuals into one comprehensive document and proposing revisions to enhance the firm's trading policies and procedures.

38. Finally, during the period of time when the Whistleblower was working from home, he requested that Paradigm communicate with him using his personal home email address in connection with preparing the report detailing the basis for his claims. Paradigm consented to his use of his personal email address and informed the Whistleblower that it would use his personal email address for future communications.

39. Approximately one month after Paradigm approved the Whistleblower's use of his personal email address, the Whistleblower sent a confidential report from his personal email account to Paradigm's CCO. This caused Paradigm to believe that the Whistleblower previously removed confidential documents using his personal email address. Paradigm reprimanded the Whistleblower for emailing this confidential document to his personal email address. On August 16, Paradigm sent a memorandum to the Whistleblower accusing him of violating Paradigm's policies and his terms of employment by removing confidential business records from Paradigm's information network. Later that same day, Paradigm sent the Whistleblower an email reiterating that, by removing confidential and proprietary records from Paradigm to his personal email account, the Whistleblower had violated the terms of a confidentiality agreement he signed when he arrived at Paradigm.

40. Paradigm had no legitimate reason for removing the Whistleblower from his position as head trader, tasking him with investigating the very conduct he had reported to the Commission, changing his job function from head trader to a full-time compliance assistant, stripping him of his supervisory responsibilities, and otherwise marginalizing him. Paradigm engaged in each of these adverse employment actions immediately after learning that the Whistleblower reported potential securities violations to the Commission.

41. The Whistleblower resigned on August 17, 2012.

VIOLATIONS

42. As a result of the conduct described above, Paradigm violated Section 21F(h) of the Exchange Act, which prohibits an employer from discharging, demoting, suspending, threatening, harassing, directly or indirectly, or in any other manner discriminating against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower in, among other things, providing information to the Commission.

43. As a result of the conduct described above, Paradigm violated, and Weir caused Paradigm's violations of, Section 206(3) of the Advisers Act, which prohibits an investment adviser from, directly or indirectly, "acting as principal for his own account, knowingly to sell any security or to purchase any security from a client ... without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."

44. As a result of the conduct described above, Paradigm violated Section 207 of the Advisers Act, which makes it unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed under the Advisers Act or willfully omit to state in any such application or report any material fact which is required to be stated therein.

UNDERTAKINGS

Respondents have undertaken to:

Payment to the Fund Investors

45. Respondents undertake, jointly and severally, to distribute, within 60 days of the date of entry of this Order, a total payment in the amount of $1,700,000 (the "Distribution") to compensate certain investors in the Fund between 2009 and 2011. This amount represents an approximation of certain administrative fees the Fund paid in connection with the principal transactions discussed herein. No portion of the Distribution shall be paid to any account in which either Respondent has a financial interest.

46. If Respondents do not distribute or return any portion of the Distribution for any reason, including an inability to locate an investor in the Fund or any factors beyond Respondents' control, Respondents shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury after the final accounting provided for in paragraphs 49-50 is approved by the Commission. Any such payment shall be made in accordance with Section IV.C below.

47. Respondents shall be responsible for administering the payment of the Distribution to certain current and former investors in the Fund. Respondents shall:

a. deposit the amount of the Distribution into an escrow account (the "Distribution Account") within 30 days of the date of entry of this Order and provide Commission staff with evidence of such deposit in a form not unacceptable to the Commission staff;

b. submit to the Commission staff, within 30 days of the date of entry of this Order, a distribution plan ("Distribution Plan") that identifies (i) each current and former investor in the Fund that will receive a portion of the Distribution ("Eligible Investors"); (ii) the exact amount of that payment as to each Eligible Investor; and (iii) the methodology used to determine the exact amount of that payment as to each Eligible Investor; and

c. within 60 days of the date of entry of this Order, complete payment of the Distribution to all Eligible Investors pursuant to the Distribution Plan.

48. Respondents shall be responsible for any and all tax compliance responsibilities associated with the Distribution and shall retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondents and the payment of taxes applicable to the Distribution Account, if any, shall not be paid out of the Distribution funds. Respondents shall not be responsible for payment of any income taxes investors owe on the portion of the Distribution they receive.

49. Within 90 days after the date of entry of this Order, Respondents shall submit to the Commission staff for its approval a final accounting and certification of the disposition of the Distribution not unacceptable to the Commission staff. The final accounting and certification shall include, but not be limited to: (i) the amount paid to each payee; (ii) the date of each payment; (iii) the check number or other identifier of money transferred or proof of payment made; (iv) the date and amount of any returned payment; (v) a description of any effort to locate a prospective payee whose payment was returned; (vi) an affirmation that the amount paid to the current and former investors in the Fund represents a fair calculation of the Distribution; and (vii) any amounts to be forwarded to the Commission for transfer to the United States Treasury. Respondents shall submit proof and supporting documentation of such payments to the Commission staff upon request. Respondents shall cooperate with reasonable requests for information in connection with the accounting and certification.

50. After Respondents have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval.

Independent Compliance Consultant

51. Respondent Paradigm shall retain, within 30 days 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 Paradigm.

52. Respondent Paradigm shall require the Consultant to conduct a comprehensive review of Paradigm's supervisory, compliance, and other policies and procedures designed to prevent and detect prohibited principal transactions including, but not limited to, Paradigm's use of any committees, advisory boards, or other groups that are involved in reviewing and approving principal transactions.

53. Respondent Paradigm shall provide to the Commission staff, within 30 days of retaining the Consultant, a copy of an engagement letter detailing the Consultant's responsibilities, which shall include the reviews described above in paragraph 52.

54. At the end of the review, which in no event shall be more than 180 days after the date of the entry of this Order, Respondent Paradigm shall submit a report approved by the Consultant (the "Report") to the staff of the Commission. The Report shall address the issues described above in paragraph 52, and shall include a description of the review performed, the conclusions reached, the Consultant's recommendations for changes in or improvements to Paradigm's policies and procedures, a procedure for implementing the recommendations or changes in or improvements to those policies and procedures, and the Consultant's approval of the foregoing.

55. Respondent Paradigm shall adopt all recommendations contained in the Report. Within 210 days after the date of the entry of this Order, Paradigm shall, in writing, advise the Consultant and the staff of the Commission of any recommendations for changes or improvements to Paradigm's policies on which Paradigm and the Consultant did not agree and the resolution of such disagreement. In the event that Paradigm and the Consultant are unable to agree on a resolution, Paradigm will abide by the recommendations of the Consultant.

56. Respondent Paradigm shall cooperate fully with the Consultant and shall provide the Consultant with access to files, books, records, and personnel as reasonably requested for the Consultant's review.

57. To ensure the independence of the Consultant, Paradigm: (i) shall not have the authority to terminate the Consultant or substitute another independent compliance consultant for the initial Consultant without the prior written approval of the Commission staff; and (ii) shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

58. Respondent Paradigm 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 existing engagement, the Consultant shall not enter into any new employment, consultant, attorney-client, auditing, or other professional relationship with Respondent Paradigm, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. 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/her duties under this Order shall not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other

professional relationship with Respondent Paradigm, 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 existing engagement.

59. Recordkeeping. Respondent Paradigm shall preserve for a period of not less than six years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of their compliance with the undertakings set forth above.

60. Deadlines. The staff of the Commission may extend any of the procedural dates set forth above for good cause shown. The procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday the next business day shall be considered to be the last day.

61. Respondent Paradigm 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 Paradigm agrees to provide such evidence. The certification and supporting material shall be submitted to Anthony S. Kelly, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5010 with a copy to the Office of Chief Counsel of the Enforcement Division, no later than 60 days from the date of the completion of the undertakings.

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Paradigm cease and desist from committing or causing any violations and any future violations of Section 21F(h) of the Exchange Act, and Sections 206(3) and 207 of the Advisers Act.

B. Respondent Weir cease and desist from committing or causing any violations and any future violations of Section 206(3) of the Advisers Act.

C. Respondents shall pay, jointly and severally, disgorgement of $1,700,000, prejudgment interest of $181,771, and a civil penalty of $300,000, for a total payment of $2,181,771. The disgorgement amount of $1,700,000 shall be deemed satisfied by the payment described above in paragraphs 45-50. The remaining balance of $481,771 shall be paid within 10 days of the entry of this order to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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

Payments by check or money order must be accompanied by a cover letter identifying Paradigm and Weir as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5010.

D. Respondents shall comply with the undertakings enumerated above in paragraphs 45-61.

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. 72403 / June 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15932

In the Matter of Applied NeuroSolutions, Inc., Cowlitz Bancorporation, First Place Financial Corp., and Kedem Pharmaceuticals, Inc., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Applied NeuroSolutions, Inc., Cowlitz Bancorporation, First Place Financial Corp., and Kedem Pharmaceuticals, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Applied NeuroSolutions, Inc. (CIK No. 872947) is a void Delaware corporation located in Vernon Hills, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Applied Neurosolutions is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010, which reported a net loss of $565,238 for the prior three months. As of June 5, 2014, the company's stock (symbol "APSN") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Cowlitz Bancorporation (CIK No. 894267) is an inactive Washington corporation located in Keslo, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cowlitz is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010, which reported a net loss of $12,231 for the prior three months. As of June 5, 2014, the company's stock (symbol "CWLZ") 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. First Place Financial Corp. (CIK No. 1068912) is a tax due Delaware corporation located in Warren, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). First Place Financial is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2010, which reported a net loss of over $31 million for the prior twelve months. As of June 5, 2014, the company's stock (symbol "FPFCQ") was quoted on OTC Link, had thirteen market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Kedem Pharmaceuticals, Inc. (CIK No. 1376228) is a revoked Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Kedem Pharmaceuticals is delinquent in its periodic filings with the Commission, having failed to include the required audited financial statements for the fiscal year ended May 31, 2012 in its Form 10-K for the period ended May 31, 2012, and having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2012, which reported a net loss of over $1.4 million for the prior six months. As of June 5, 2014, the company's stock (symbol "KDMP") was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

7. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 17, 2014

In the Matter of **Applied NeuroSolutions, Inc.,** **Cowlitz Bancorporation,** **First Place Financial Corp., and** **Kedem Pharmaceuticals, 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 Applied NeuroSolutions, Inc. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Cowlitz Bancorporation because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of First Place Financial Corp. because it has not filed any periodic reports since the period ended June 30, 2010.

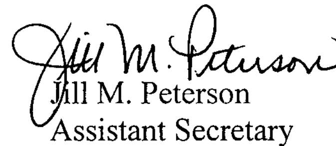
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Kedem Pharmaceuticals, Inc. because it failed to include the required audited financial statements for the fiscal

year ended May 31, 2012 in its Form 10-K for the period ended May 31, 2012, and it failed to file any periodic reports since it filed a Form 10-Q for the period ended November 30, 2012.

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 June 17, 2014, through 11:59 p.m. EDT on June 30, 2014.

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. 72401 / June 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15931

In the Matter of **Crescent Banking Co.,** **Data Storage Consulting Services, Inc.,** **First National Bancshares, Inc.,** **Infosmart Group, Inc.,** **Marco Community Bancorp, Inc., and** **Sun River Energy, Inc. (n/k/a** **New River Exploration, Inc.),** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Crescent Banking Co., Data Storage Consulting Services, Inc., First National Bancshares, Inc., Infosmart Group, Inc., Marco Community Bancorp, Inc., and Sun River Energy, Inc. (n/k/a New River Exploration, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Crescent Banking Co. (CIK No. 883476) is a Georgia corporation located in Jasper, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Crescent Banking is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010, which reported a net loss of over $13.5 million for the

prior three months. As of June 5, 2014, the company's stock (symbol "CSNT") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Data Storage Consulting Services, Inc. (CIK No. 1407313) is a delinquent Colorado corporation located in Shenzhen, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Data Storage Consulting is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010, which reported a net loss of $87,378 since its December 12, 2006 inception. As of June 5, 2014, the company's stock (symbol "DTAS") was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. First National Bancshares, Inc. (CIK No. 1095274) is a South Carolina corporation located in Spartanburg, South Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). First National Bancshares is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010, which reported a net loss of over $5.3 million for the prior three months. As of June 5, 2014, the company's stock (symbol "FNSPQ") 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. Infosmart Group, Inc. (CIK No. 1066961) is a suspended California corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Infosmart is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010, which reported a net loss of over $2.49 million for the prior three months. As of June 5, 2014, the company's stock (symbol "IFSG") 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. Marco Community Bancorp, Inc. (CIK No. 1221354) is a Florida corporation located in Marco Island, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Marco Community Bancorp 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 $587,000 for the prior six months. As of June 5, 2014, the company's stock (symbol "MCBN") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Sun River Energy, Inc. (n/k/a New River Exploration, Inc.) (CIK No. 1066551) is a Colorado corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sun River is delinquent in its periodic filings with the Commission, having failed to include the required audited financial statements for the fiscal year ended April 30, 2011 in its Form 10-K for the period ended April 30, 2012, and having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2012. As of June 5, 2014, the

company's stock (symbol "SNRV") was quoted on OTC Link, had twelve market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 17, 2014

In the Matter of **Crescent Banking Co.,** **Data Storage Consulting Services, Inc.,** **First National Bancshares, Inc.,** **Infosmart Group, Inc.,** **Marco Community Bancorp, Inc., and** **Sun River Energy, Inc. (n/k/a** **New River Exploration, 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 Crescent Banking Co. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Data Storage Consulting Services, Inc. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of First National Bancshares, Inc. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Infosmart Group, Inc. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Marco Community Bancorp, 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 Sun River Energy, Inc. (n/k/a New River Exploration, Inc.) because it failed to include the required audited financial statements for the fiscal year ended April 30, 2011 in its Form 10-K for the period ended April 30, 2012, and failed to file any periodic reports since it filed a Form 10-Q for the period ended July 31, 2012.

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 June 17, 2014, through 11:59 p.m. EDT on June 30, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES AND EXCHANGE ACT OF 1934
Release No. 72409 / June 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-13533

In the Matter of Robert D. Graham, Esq.	: : : : : :	ORDER UNDER RULE 102(e)(5)(ii) OF THE COMMISSION'S RULES OF PRACTICE PERMITTING ATTORNEY TO RESUME APPEARING AND PRACTICING BEFORE THE COMMISSION

I.

On July 1, 2009, the Commission entered an Order of Forthwith Suspension Pursuant to Rule 102(e)(2)[1] of the Commission's Rules of Practice ("Order") that suspended Robert D. Graham from appearing or practicing before the Commission as an attorney. *In the Matter of Robert D. Graham, Esq.*, Exchange Act Rel. No. 34-60219 (July 1, 2009). The Commission's Order was based on Graham's criminal conviction on sixteen felony counts, including securities fraud and making false statements to the Commission. *U.S. v. Graham*, Case No. 3:06-cr-137 (D. Conn.).

On August 1, 2011, the U.S. Court of Appeals for the Second Circuit vacated Graham's conviction and remanded the case for a new trial. *U.S. v. Graham*, 653 F.3d 61 (2nd Cir. 2011). Graham was not retried. Instead, on June 22, 2012, Graham entered into a Deferred Prosecution Agreement ("DPA") with the Department of Justice. On June 25, 2012, the district court accepted the DPA and entered an order deferring the matter for one year. On June 27, 2013, pursuant to the terms of the DPA and DPA Order, the Department of Justice filed a motion to dismiss the superseding indictment against Graham. On July 1, 2013, the district court issued an order granting the motion to dismiss the superseding indictment, and it was dismissed the same day.

[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."

II.

After the criminal action was dismissed, Graham filed an application for reinstatement of the privilege of appearing and practicing before the Commission pursuant to Commission Rule of Practice 102(e)(5)(ii).[2] As part of the reinstatement process, Graham has provided evidence that he has complied with the Commission's Order; that he is no longer subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession; and that all the grounds for application of Rule 102(e)(2) have been removed by the reversal of his criminal conviction. No other information has come to the attention of the Commission relating to Graham's character, integrity, professional conduct, or qualifications to practice before the Commission that would be a basis for denying his application, or that would be a basis for an action against him pursuant to Rule 102(e) of the Commission's Rules of Practice.

III.

Based on the foregoing, the Commission has determined that it is appropriate to reinstate Graham, pursuant to Rule 102(e)(5)(ii), the privilege of appearing and practicing before the Commission.

Accordingly, it is HEREBY ORDERED that Robert D. Graham is reinstated to appear and practice as an attorney before the Commission.

By the Commission.

Jill M. Peterson
Assistant Secretary

[2] That provision states, in relevant part: "Any person suspended under paragraph (e)(2) of this rule shall be reinstated by the Commission, upon appropriate application, if all the grounds for application of the provisions of that paragraph are subsequently removed by a reversal of the conviction or termination of the suspension, disbarment, or revocation."

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 232

[Release Nos. 33-9600; 34-72394; 39-2497; IC-31081]

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 support the US GAAP 2014 Taxonomy, validate the filings containing EX-101 XBRL documents, update the Public Validation Criteria validation in EX-101.INS documents, change the ABS Asset Class value "Corporate Debt" for ABS-15G and ABS-15G/A to "Debt Securities," disseminate unofficial PDF copies of COVER and CORRESP attachments to EDGARLink Online submissions at the discretion of the SEC, update the Frequently Asked Questions (FAQ) screens, and revise the N-SAR system requirements. The EDGAR system is scheduled to be upgraded to support this functionality on June 16, 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 Division of Corporation Finance, for questions concerning dissemination of unofficial PDF copies of COVER and CORRESP attachments to EDGARLink Online submissions contact Heather Mackintosh at (202) 551-3600; in the Division of Economic and Risk Analysis, for questions concerning taxonomies update and

XBRL contact Walter Hamscher at (202) 551-5397; 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, Volume II, and Volume III. The Filer Manual describes the technical formatting requirements for the preparation and submission of electronic filings through the EDGAR system.[1] 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 17 (June 2014), Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 27 (June 2014), and Volume III entitled EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 3 (June 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 14.1 on June 16, 2014 and will introduce the following changes: EDGAR will be updated to support the US GAAP 2014 Taxonomy. In

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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 March 3, 2014. See Release No. 33-9554 (March 10, 2014) [79 FR 13216].

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

[3] See Release No. 33-9554 in which we implemented EDGAR Release 14.0. For additional history of Filer Manual rules, please see the cites therein.

addition, EDGAR will no longer provide support for the US GAAP 2012 Taxonomy and the US 2011 DEI Taxonomy. Please see http://www.sec.gov/info/edgar/edgartaxonomies.shtml for a complete listing of supported standard taxonomies.

Filings containing the EX-101 XBRL documents will be validated to ensure that:

- EX-101 exhibits do not contain custom elements with a fractionItemType declaration.
- EX-101 exhibits with numerical elements do not have a value and decimal attribute combination that would cause non-zero digits to be truncated to zero.
- EX-101 exhibits with non-numeric elements do not have label roles, such as "negated," "zero," and "positive" that imply they are numeric.
- EX-101 exhibits do not contain an element declaration for which xbrli:periodType is instant and its base type is non-numeric.
- EX-101.INS XBRL documents do not contain contexts that include the xbrli:forever context element.

The Public Validation Criteria validation [fs-0509-Start-And-End-Dates-Not-Distinct-Inconsistent-With-Document-Type] has been updated to allow individual context durations in EX-101.INS documents that are equal to or greater than 24 hours.

The ABS Asset Class value "Corporate Debt" for ABS-15G and ABS-15G/A submission form types will be changed to "Debt Securities." This change will not impact previous ABS-15G and ABS-15G/A submissions where filers selected "Corporate Debt" as the ABS Asset Class value.

Unofficial PDF copies of COVER and CORRESP attachments to EDGARLink Online submissions will now be disseminated at the discretion of the SEC.

The Frequently Asked Questions (FAQ) screens of the EDGAR Filing Website and the EDGAR Filer Management Website have been updated to include a new "EDGAR Quick Reference Guides" hyperlink. On clicking this hyperlink, filers are presented with a list of hyperlinks to the Quick Reference Guides in the lower pane of the window.

Section 2.1 of the "EDGAR Filer Manual, Volume III: N-SAR Supplement" has been revised to update the following N-SAR system requirements. (Note: The procedure for filing Form N-SAR, the Semi-Annual Report for Registered Investment Companies has not changed.)

- The N-SAR PC application (Version 6.1.a) is supported by 16-bit and 32-bit Windows-based Operating Systems.
- The references to modem and the Netscape browser have been deleted. The Internet browsers recommended for transmitting N-SAR submissions include Internet Explorer 7.0 through 8.0, and Firefox 17.0 or later.

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.

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).[4] It follows that the requirements of the Regulatory Flexibility Act[5] 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,[6] 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 14.1 is scheduled to become available on June 16, 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,[7] Sections 3, 12, 13, 14, 15, 23, and 35A of the Securities Exchange Act of 1934,[8] Section 319 of the Trust Indenture Act of 1939,[9] and Sections 8, 30, 31, and 38 of the Investment Company Act of 1940.[10]

List of Subjects in 17 CFR Part 232

Incorporation by reference, Reporting and recordkeeping requirements, Securities.

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4 5 U.S.C. 553(b).

5 5 U.S.C. 601 - 612.

6 5 U.S.C. 553(d)(3).

7 15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a).

8 15 U.S.C. 78c, 78l, 78m, 78n, 78o, 78w, and 78ll.

9 15 U.S.C. 77sss.

10 15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37.

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.

*****

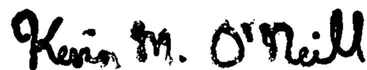
2. Section 232.301 is revised to read as follows:

§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 17 (June 2014). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 27 (June 2014). Additional provisions applicable to Form N-SAR filers are set forth in the EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 3 (June 2014). 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.



Kevin M. O'Neill
Deputy Secretary

June 16, 2014

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31082 / June 16, 2014

In the Matter of

CREDIT SUISSE ASSET MANAGEMENT, LLC
CREDIT SUISSE ASSET MANAGEMENT LIMITED
CREDIT SUISSE HEDGING-GRIFFO SERVICOS
INTERNACIONAIS S.A.
CREDIT SUISSE AG
CREDIT SUISSE GROUP AG

c/o Credit Suisse Asset Management, LLC
One Madison Avenue
New York, NY 10010

CREDIT SUISSE SECURITIES (USA) LLC

Eleven Madison Avenue
New York, NY 10010

(812-14313)

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

Credit Suisse Asset Management, LLC, Credit Suisse Asset Management Limited, Credit Suisse Hedging-Griffo Servicos Internacionais S.A., Credit Suisse Securities (USA) LLC, Credit Suisse AG ("CSAG") (collectively, "Applicants"), and Credit Suisse Group AG (solely with respect to a condition as noted in the application), filed an application on May 19, 2014, with a filing date of May 20, 2014, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which CSAG is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the Act with respect to a guilty plea entered on May 19, 2014, by CSAG in the United States District Court for the Eastern District of Virginia.

On May 19, 2014, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 31051) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

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

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations and conditions contained in the application filed by Credit Suisse Asset Management, LLC, et al. (File No. 812-14313) that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of a guilty plea, described in the application, entered by CSAG in the United States District Court for the Eastern District of Virginia on May 19, 2014.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9601 / June 17, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72414 / June 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15933

In the Matter of

MICHAEL C. FRENCH, Esq.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and admits the

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

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

findings contained in Section III, and Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. French, age 71, is a Texas resident living in Dallas, Texas. French is a member of the Texas state bar. French served as a Director of Scottish Annuity & Life Holdings Ltd. (now known as Scottish Re group Limited)("Scottish Re") from May 1998 until May 2007, as its CEO from May 1998 until January 2005, and as its Chairman from March 2000 through March 2006. He also served as a Director of Michaels Stores, Inc. ("Michaels") and Sterling Software, Inc. ("Sterling Software") from 1992 until 2000. French was a partner in the law firm of Jackson Walker LLP from 1976 until 1992. He was a consultant to the law firm of Jones Day from 1995 to 2000. French holds a law degree from Baylor University.

2. At the time of the conduct described in this Order, the common stock of Scottish Re, Sterling Software, and Michaels was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and listed on the New York Stock Exchange.

3. On July 29, 2010, the Commission filed a complaint against French in Securities and Exchange Commission v. Samuel E. Wyly, et al., Civil Action Number 10-5760 (SAS), in the United States District Court for the Southern District of New York. On March 21, 2014, the court entered an order permanently enjoining French by consent from future violations of Sections 10(b) of the Exchange Act, Rule 10b-5 thereunder, Section 13(d) of the Exchange Act and Exchange Act Rules 132-1 and13d-2. The final judgment also ordered him to pay disgorgement of $400,000 and prejudgment interest in the amount of $394,608.84.

4. French made the following admissions. French assisted Sam Wyly and Charles Wyly ("the Wylys") in establishing a network of offshore trusts and subsidiary companies that traded in the securities of four public companies – Scottish Re, Sterling Software, Sterling Commerce and Michaels – for which the Wylys were insiders. The Wylys did not disclose these trades or include the securities held by the offshore trusts (either directly or through subsidiary companies) in their public filings with the Commission. French assisted the Wylys in their efforts to influence the offshore trusts by serving as a protector for those trusts and passing on recommendations for securities transactions. All of the recommendations originated with the Wylys and were followed by the offshore trusts. French took several actions that assisted the Wylys in concealing the appearance of control over the offshore trusts by the Wylys. Those actions had the effect of concealing information relevant to the Wylys' beneficial ownership of the securities held by the offshore companies.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, effective immediately, that:

French is suspended from appearing or practicing before the Commission as an attorney.

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. 72417 / June 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15934

In the Matter of **AISystems, Inc.** **(a/k/a Airline Intelligence Systems, Inc.),** **Baeta Corp.,** **China Jianye Fuel, Inc.,** **Cordex Pharma, Inc.,** **Diamondhead Casino Corporation,** **Emerald Dairy, Inc., and** **Kentucky Energy, 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. AISystems, Inc. (a/k/a Airline Intelligence Systems, Inc.) ("ASYI") (CIK No. 1328769) is a revoked Nevada corporation located in Wilmington, Delaware with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ASYI 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, 2012. As of June 16, 2014, the common stock of ASYI was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink

[1] The short form of each issuer's name is also its stock symbol.

Sheets") ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Baeta Corp. ("BAEA") (CIK No. 1439636) is a New Jersey corporation located in Fort Lee, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BAEA 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 $1,133,724 for the prior nine months. As of June 16, 2014, the common stock of BAEA 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. China Jianye Fuel, Inc. ("CJYF") (CIK No. 1390662) is a forfeited Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CJYF 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. As of June 16, 2014, the common stock of CJYF 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. Cordex Pharma, Inc. ("CDXP") (CIK No. 1127842) is a revoked Nevada corporation located in Philadelphia, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CDXP 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 $7,291,938 for the prior nine months. As of June 16, 2014, the common stock of CDXP 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. Diamondhead Casino Corporation ("DHCC") (CIK No. 844887) 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). DHCC 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 $800,675 for the prior six months. As of June 16, 2014, the common stock of DHCC was quoted on OTC Link, had eleven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Emerald Dairy, Inc. ("EMDY") (CIK No. 815353) is a revoked Nevada corporation located in Reston, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EMDY 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. As of June 16, 2014, the common stock of EMDY was quoted on OTC Link, had eleven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Kentucky Energy, Inc. ("QMIN") (CIK No. 1130126) is an expired Utah corporation located in Paterson, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). QMIN 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 $3,523,572 for the prior three months. As of June 16, 2014, the common stock of QMIN 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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 18, 2014

In the Matter of AISystems, Inc. (a/k/a Airline Intelligence Systems, Inc.), Baeta Corp., China Jianye Fuel, Inc., Cordex Pharma, Inc., Diamondhead Casino Corporation, Emerald Dairy, Inc., and Kentucky Energy, 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 AISystems, Inc. (a/k/a Airline Intelligence Systems, Inc.) because it has not filed any periodic reports since the period ended March 31, 2012.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Baeta 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 China Jianye Fuel, 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 Cordex Pharma, Inc. because it has not filed any periodic reports since the period ended September 30, 2009.

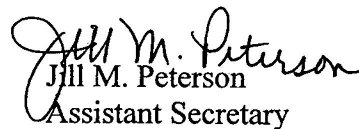
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Diamondhead Casino Corporation because it has not filed any periodic reports since the period ended June 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Emerald Dairy, 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 Kentucky Energy, Inc. because it has not filed any periodic reports since the period ended March 31, 2011.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed 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 June 18, 2014, through 11:59 p.m. EDT on July 1, 2014.

By the Commission.



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. 72427 / June 18, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3558 / June 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15938

In the Matter of **I. JOHN BENSON, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

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

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

herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Benson, age 67, held a Texas CPA license until voluntarily surrendering it in 2008. He served as Chief Financial Officer of DGSE Companies Inc. ("DGSE") from 1992 until 2011.

2. DGSE was, at all relevant times, a Nevada corporation headquartered in Dallas, Texas that buys and sells jewelry and bullion products for individual consumers, dealers, and institutions. Its common stock is registered with the Commission under Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and is traded on the NYSE MKT under the symbol "DGSE."

3. On June 2, 2014, a final judgment was entered against Benson, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14, 13b2-1, and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13, in the civil action entitled Securities and Exchange Commission v. DGSE Companies Inc. and I. John Benson, Civil Action Number 3:14-cv-01909-B, in the United States District Court for the Northern District of Texas. Benson was also ordered to pay a $75,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Benson engaged in a fraudulent scheme which resulted in DGSE filing materially false and misleading financial statements in the company's annual report on DGSE's Forms 10-K for the Fiscal Years Ended December 31, 2009 and December 31, 2010, as well as quarterly filings for the same period. Benson also allegedly signed false management certifications, which were attached to these filings. In addition, the complaint alleged that while Benson was DGSE's CFO, DGSE failed to maintain sufficient accounting controls, and that Benson circumvented the controls that DGSE did have. Finally, the complaint alleged that Benson made false statements to DGSE's external auditors.

IV.

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

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

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. 72429 / June 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-14641

In the Matter of **CHARLES L. RIZZO and GINA M. HORNBOGEN,** **Respondents.**	:	**NOTICE OF AMENDED PROPOSED PLAN OF DISTRIBUTION AND OPPORTUNITY FOR COMMENT**

Notice is hereby given, pursuant to Rule 1103 of the Securities and Exchange Commission's ("Commission") Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103, that the Division of Enforcement has submitted to the Commission an amended proposed plan for the distribution of monies placed into a Fair Fund established in the above-captioned matter. On September 30, 2013, the Commission issued a Notice of Proposed Plan of Distribution and Opportunity for Comment (Exchange Act Rel. No. 70573 (Sept. 30, 2013)). The Plan has been amended from the Proposed Distribution Plan previously noticed on September 30, 2013 in order to respond to the comments received and include two additional Eligible Fair Fund recipients

On July 20, 2012, the Commission issued an Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Section 15(b)(6) of the Securities Exchange Act of 1934 against Charles L. Rizzo ("Rizzo") and Gina M. Hornbogen ("Hornbogen") (collectively, "Respondents") (the "Order") (Exchange Act Rel. No. 67479 (July 20, 2012)). The Order found that Respondents failed reasonably to supervise Steven Salutric ("Salutric"), who, while acting as an investment adviser for Results One Financial, LLC, misappropriated millions of dollars from his advisory clients at Results One.

In the Order, Rizzo was ordered to pay disgorgement of $35,079, prejudgment interest of $7,731, and civil penalties of $130,000, and Hornbogen was ordered to pay disgorgement of $15,592, prejudgment interest of $3,467, and civil penalties of $25,000. The Order created a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. The Fair Fund is comprised of the disgorgement, prejudgment interest and penalties ordered to be paid by Respondents, for distribution to clients of Results One who suffered a net loss of funds as a result of Salutric's misappropriation of funds during the period of time, June 1, 2003 through December 31, 2009, when the Respondents failed to reasonably supervise Salutric (collectively, "Eligible Clients").

OPPORTUNITY FOR COMMENT

Pursuant to this Notice, all interested parties are advised that they may obtain a copy of the Amended Proposed Plan of Distribution (the "Amended Plan") from the Commission's public website, http://www.sec.gov. Interested parties may also obtain a written copy of the Amended Plan by submitting a written request to Nancy Chase Burton, Esq., United States Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5631. All persons who desire to comment on the Plan may submit their comments, in writing, no later than thirty (30) days from the date of this Notice:

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

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

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

Comments submitted by email or via the Commission's website should include "Administrative Proceeding File Number 3-14641" in the subject line. Comments received will be publicly available. Persons should submit only information that they wish to make publicly available.

THE DISTRIBUTION PLAN

The Fair Fund is comprised of the amounts of disgorgement, prejudgment interest and civil monetary penalties paid by Respondents, less any federal, state, or local taxes and fees and expenses. Rizzo has paid $172,810 in disgorgement, prejudgment interest and civil monetary penalties, and Hornbogen has paid $29,202.05 in disgorgement, prejudgment interest, and civil monetary penalties. The remainder of Hornbogen's payments in the amount of $14,856.95, plus post-order interest, is to be paid in installments through July 2015. It is anticipated that there will be two disbursements to the Eligible Clients, the latter of which is anticipated to occur after all scheduled payments have been received.

The Amended Plan adds two Eligible Clients and provides for all Eligible Clients to receive monies from the Fair Fund that represents their proportionate share of the distributable amount of the Fair Fund. Eligible Clients will not need to go through a claims process; rather, they will be determined from available records. The Eligible Clients will not be required to make claims or submit documentation to establish their eligibility. The Amended Plan provides that on the basis of information obtained by the Commission staff through review and analysis of applicable records, the Fund Administrator will identify the Eligible Clients. Within thirty (30) days of the Commission's approval of the Amended Plan, the Fund Administrator will send each Eligible Client a notice by United States Postal Service regarding the Commission's approval of the Amended Plan, including as appropriate, a statement characterizing the distribution, a link to the Amended Plan posted on the Commission's website and instructions for requesting a copy of the Amended Plan, a Net Loss Amount calculation and a preliminary Gross Distribution Amount, a

description of the tax information reporting and other related tax matters, the procedure for the distribution as set forth in the Amended Plan, and the name of the Fund Administrator to contact with questions regarding the distribution. The Fund Administrator will coordinate with the appointed Tax Administrator to request information from each Eligible Client that is needed to accomplish the distribution in accordance with applicable tax requirements relating to the Fair Fund.

The Amended Plan provides procedures for Eligible Clients to dispute the amounts received. Disputes will be limited to calculations of disbursement amounts to Eligible Clients. Should an Eligible Client wish to dispute the amount received, an Eligible Client must submit a written communication to the Fund Administrator, Nancy Chase Burton, Esq., United States Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5631. The Fund Administrator must receive the written communication detailing the dispute along with any supporting documentation within thirty days of the date that an Eligible Client's disbursement is made. The Fund Administrator will investigate the dispute, and such investigation will include a review of the written dispute as well as any supporting documentation. Within thirty days of receipt of the written dispute, the Fund Administrator will notify the Eligible Client of the resolution of the dispute, which shall be final.

By the Commission.

Lynn M. Powalski
Deputy Secretary

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Friday, June 13, 2014

Part XXVII

Securities and Exchange Commission

Semiannual Regulatory Agenda

56 of 78

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: Semiannual regulatory agenda.

SUMMARY: The Securities and Exchange Commission is publishing an agenda of its rulemaking actions pursuant to the Regulatory Flexibility Act (RFA) (Pub. L. No. 96–354, 94 Stat. 1164) (Sep. 19, 1980). Information in the 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 since that date have been reflected in the agenda. The Commission invites questions and public comment on the agenda and on the individual agenda entries.

The Commission is now printing in the **Federal Register**, along with our preamble, only those agenda entries for which we have indicated that preparation of an RFA analysis is required.

The Commission's complete RFA agenda will be available online at *www.reginfo.gov*.

DATES: Comments should be received on or before July 14, 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/other.shtml*); or
- Send an email 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 No. S7–04–14. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/other.shtml*). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; 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 RFA requires each Federal agency, twice each year, to publish in the **Federal Register** an agenda identifying rules that the agency expects to consider in the next 12 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 12 months. The agenda includes new entries, entries carried over from prior publications, and rulemaking actions that have been completed (or withdrawn) since publication of the last agenda.

The following abbreviations for the acts administered by the Commission are used in the agenda:

"Securities Act"—Securities Act of 1933

"Exchange Act"—Securities Exchange Act of 1934

"Investment Company Act"—Investment Company Act of 1940

"Investment Advisers Act"—Investment Advisers Act of 1940

"Dodd-Frank Act"—Dodd-Frank Wall Street Reform and Consumer Protection Act

The Commission invites public comment on the agenda and on the individual agenda entries.

By the Commission.

Dated: March 21, 2014.

Kevin O'Neill,

Deputy Secretary.

DIVISION OF CORPORATION FINANCE—PROPOSED RULE STAGE

Sequence No.	Title	Regulation Identifier No.
401	Implementation of Titles V and VI of the JOBS Act	3235–AL40
402	Treatment of Certain Communications Involving Security-Based Swaps That May be Purchased Only by Eligible Contract Participants.	3235–AL41

DIVISION OF CORPORATION FINANCE—FINAL RULE STAGE

Sequence No.	Title	Regulation Identifier No.
403	Rules Governing the Offer and Sale of Securities Through Crowdfunding Under Section 4(a)(6) of the Securities Act.	3235–AL37
404	Amendments to Regulation D, Form D and Rule 156 Under the Securities Act	3235–AL46

DIVISION OF INVESTMENT MANAGEMENT—PROPOSED RULE STAGE

Sequence No.	Title	Regulation Identifier No.
405	Rule for Principal Trades With Certain Advisory Clients	3235–AL56

DIVISION OF INVESTMENT MANAGEMENT—FINAL RULE STAGE

Sequence No.	Title	Regulation Identifier No.
406	References to Credit Ratings in Certain Investment Company Act Rules and Forms	3235–AL02

DIVISION OF TRADING AND MARKETS—FINAL RULE STAGE

Sequence No.	Title	Regulation Identifier No.
407	Rules for Nationally Recognized Statistical Rating Organizations	3235–AL15

DIVISION OF TRADING AND MARKETS—LONG-TERM ACTIONS

Sequence No.	Title	Regulation Identifier No.
408	Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934	3235–AL14

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Corporation Finance

Proposed Rule Stage

401. Implementation of Titles V and VI of the JOBS Act

Legal Authority: Pub. L. 112–106

Abstract: The Division is considering recommending that the Commission propose rules or amendments to rules to implement titles V (Private Company Flexibility and Growth) and VI (Capital Expansion) of the JOBS Act.

Timetable:

Action	Date	FR Cite
NPRM	10/00/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Steven G. Hearne, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3430.

RIN: 3235–AL40

402. Treatment of Certain Communications Involving Security-Based Swaps That May Be Purchased Only by Eligible Contract Participants

Legal Authority: Not Yet Determined

Abstract: The Division is considering recommending that the Commission propose a rule under the Securities Act to address the treatment of certain communications involving security-based swaps that may be purchased only by eligible contract participants.

Timetable:

Action	Date	FR Cite
NPRM	05/00/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Andrew Schoeffler, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3860.

RIN: 3235–AL41

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Corporation Finance

Final Rule Stage

403. Rules Governing the Offer and Sale of Securities Through Crowdfunding Under Section 4(a)(6) of the Securities Act

Legal Authority: 15 U.S.C. 77a *et seq.;* 15 U.S.C. 78a *et seq.;* Pub. L. 112–108, secs 301 to 305

Abstract: The Commission proposed rules to implement title III of the JOBS Act by prescribing rules governing the offer and sale of securities through crowdfunding under new section 4(a)(6) of the Securities Act.

Timetable:

Action	Date	FR Cite
NPRM	11/05/13	78 FR 66428
NPRM Comment Period End.	02/03/14	
Final Action	10/00/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Sebastian Gomez Abero, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3500.

Leila Bham, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–5532.

RIN: 3235–AL37

404. Amendments to Regulation D, Form D and Rule 156 Under the Securities Act

Legal Authority: 15 U.S.C. 77a *et seq.*

Abstract: The Commission proposed rule and form amendments to enhance the Commission's ability to evaluate the development of market practices in offerings under Rule 506 of Regulation D and address concerns that may arise in connection with permitting issuers to engage in general solicitation and general advertising under new paragraph (c) of Rule 506.

Timetable:

Action	Date	FR Cite
NPRM	07/24/13	78 FR 44806
NPRM Comment Period End.	09/23/13	
NPRM Comment Period Re-opened.	10/03/13	78 FR 61222
NPRM Comment Period End.	11/04/13	
Final Action	10/00/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Charles Kwon, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3500.

Ted Yu, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3500.

RIN: 3235–AL46

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Investment Management

Proposed Rule Stage

405. • Rule for Principal Trades With Certain Advisory Clients

Legal Authority: 15 U.S.C. 80b–6a; 15 U.S.C. 80b–11(a)

Abstract: Rule 206(3)–3T, a rule that provides investment advisers who are also registered broker-dealers an alternative means of compliance with the principal trading restrictions in section 206(3) of the Investment Advisers Act, will expire on December 31, 2014.

Timetable:

Action	Date	FR Cite
Next Action	12/00/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Sarah Buescher, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–5192, *Email: bueschers@sec.gov.*

RIN: 3235–AL56

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Investment Management

Final Rule Stage

406. References to Credit Ratings in Certain Investment Company Act Rules and Forms

Legal Authority: 15 U.S.C. 80a–6(c); 15 U.S.C. 80a–8; 15 U.S.C. 80a–14(a); 15 U.S.C. 80a–29; 15 U.S.C. 80a–30(a); 15 U.S.C. 80a–37; 15 U.S.C. 77e; 15 U.S.C. 77f; 15 U.S.C. 77g; 15 U.S.C. 77j; 15 U.S.C. 77s(a); Pub. L. 111–203, sec 939A

Abstract: The Commission proposed amendments to two rules (Rules 2a–7 and 5b–3) and four forms (Forms N–1A, N–2, N–3, and N–MFP) under the Investment Company Act that reference credit ratings. These proposals would give effect to section 939A of the Dodd Frank Act. The Commission adopted amendments to Rule 5b–3 and Forms N–1A, N–2, and N–3. Further action will need to be taken with respect to Rule 2a–7 and Form N–MFP.

Timetable:

Action	Date	FR Cite
NPRM	03/09/11	76 FR 12896
NPRM Comment Period End.	04/25/11	
Final Action	11/23/12	77 FR 70117
Final Action Effective.	12/24/12	
Final Action	01/08/14	79 FR 1316
Final Action Effective.	07/07/14	
Final Action	10/00/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Adam Bolter, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–6792.

RIN: 3235–AL02

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Trading and Markets

Final Rule Stage

407. Rules for Nationally Recognized Statistical Rating Organizations

Legal Authority: 15 U.S.C. 78o–7; 15 U.S.C. 78q; 15 U.S.C. 78mm; Pub. L. 111–203, secs 936, 938, and 943

Abstract: The Commission proposed rules and rule amendments to implement certain provisions of the Dodd Frank Act concerning nationally recognized statistical rating organizations, providers of third-party due diligence services for asset-backed securities, and issuers and underwriters of asset-backed securities.

Timetable:

Action	Date	FR Cite
NPRM	06/08/11	76 FR 33420
NPRM Comment Period End.	08/08/11	
Final Action	05/00/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Raymond Lombardo, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–5755, *Email: lombardor@sec.gov.*

RIN: 3235–AL15

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Trading and Markets

Long-Term Actions

408. Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934

Legal Authority: Pub. L. 111–203, sec 939A

Abstract: Section 939A of the Dodd Frank Act requires the Commission to remove certain references to credit ratings from its regulations and to substitute such standards of creditworthiness as the Commission determines to be appropriate. The Commission amended certain rules and one form under the Exchange Act applicable to broker-dealer financial responsibility, and confirmation of transactions. The Commission has not yet finalized amendments to certain rules regarding the distribution of securities.

Timetable:

Action	Date	FR Cite
NPRM	05/06/11	76 FR 26550
NPRM Comment Period End.	07/05/11	
Final Action	01/08/14	79 FR 1522
Final Action Effective.	07/07/14	
Next Action Undetermined.	To Be Determined	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: John Guidroz, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-6439.

RIN: 3235–AL14

[FR Doc. 2014–13146 Filed 6–12–14; 8:45 am]

BILLING CODE 8011–01–P

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72431 / June 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15703

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to accept the Offer of Settlement submitted by Douglas Costabile ("Respondent") pursuant to Rule 240(a) of the Rules of Practice of the Commission, 17 C.F.R. § 201.240(a), for the purpose of settlement of these proceedings initiated against Respondent on January 29, 2014, pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. From January 2001 to January 2006, Costabile was a registered representative associated with Joseph Stevens & Co., Inc., which, at the time of his association, was a broker-dealer registered with the Commission. Joseph Stevens & Co. ceased to be registered with the Commission as of August 2008. Costabile, age 45, is a resident of New York.

2. On August 24, 2009, before the New York Supreme Court in People v. Douglas Costabile, Case No. 2394-2009, Costabile pleaded guilty to one felony count of attempted enterprise corruption in violation of New York Penal Law § 110-460.20 and one felony count of grand larceny in the third degree in violation of New York Penal Law § 155.35. On July 20, 2012, Costabile was sentenced in that proceeding to conditional discharge and ordered to pay $32,223 in restitution.

3. The attempted enterprise corruption count of the criminal indictment to which Costabile pleaded guilty arose out of the conduct of a broker-dealer and alleged, among other things, that between January 2001 and December 2005, Costabile participated in a scheme at Joseph Stevens & Co. to defraud investors by coordinating with traders to sell and buy stocks to and from their customers, after successfully manipulating the price of the stocks, at prices unfavorable to their customers, to generate illegally inflated profits that were shared by members of the criminal enterprise. The scheme involved the securities of numerous companies, including Cypress Bioscience, Inc. and Antigenics, Inc. The grand larceny count of the criminal indictment to which Costabile pleaded guilty alleged that between April 2003 and August 2004, Costabile stole more than three thousand dollars from an individual.

IV.

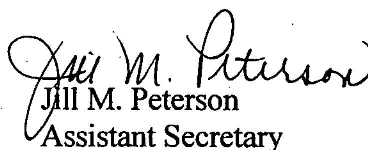
In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Costabile 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 the 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
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 72435 / June 19, 2014

Admin. Proc. File No. 3-15851

In the Matter of BRIAN WILLIAMSON, ESQ.	ORDER DENYING MOTION TO LIFT TEMPORARY SUSPENSION AND DIRECTING HEARING

On April 22, 2014, we issued an order ("Temporary Suspension Order"), pursuant to Commission Rule of Practice 102(e)(3)(i)(B),[1] temporarily suspending Brian Williamson, Esq., an attorney licensed to practice law in Pennsylvania and New Jersey but currently on "retired" status in both jurisdictions, from appearing or practicing before the Commission as an attorney.[2] Williamson has now filed a timely petition, pursuant to Rule 102(e)(3)(ii),[3] requesting that his temporary suspension be lifted. For the reasons set forth below, we have determined to deny Williamson's petition and to set the matter down for a hearing before an administrative law judge.

On August 20, 2013, we entered an order instituting administrative proceedings ("OIP") against Williamson, the former manager of Oppenheimer Global Resource Private Equity Fund I, L.P. ("OGR"), alleging that, between September 2009 and June 2010, Williamson made material false and misleading statements and omissions to investors and prospective investors concerning OGR's valuation.[4] Specifically, the OIP alleged that Williamson marketed OGR using materials

1 17 C.F.R. § 201.102(e)(3)(i)(B) (authorizing the Commission to temporarily suspend from appearing or practicing before it an attorney who has been "[f]ound by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party or found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder").

2 *Brian Williamson*, Securities Exchange Act Release No. 71994, 2014 WL 1603592 (Apr. 22, 2014).

3 17 C.F.R. § 201.102(e)(3)(ii).

4 *Brian Williamson*, Exchange Act Release No. 70234, 2013 WL 4431203 (Aug. 20, 2013).

that reported an internal rate of return that, misleadingly, did not take into account OGR fees and expenses that would have materially lowered OGR's reported internal rate of return.[5] The OIP also alleged that Williamson made material misrepresentations and omissions designed to hide his role in valuing OGR's largest holding and to create the misleading impression that OGR's increased internal rate of return was due to increased performance when, in fact, it was not.[6] The OIP alleged that OGR raised approximately $61 million in new investments during this period.[7]

On January 22, 2014, we entered an order making findings and imposing remedial sanctions against Williams, who consented to the entry of this order without admitting or denying liability ("Settlement Order").[8] The Settlement Order found that Williamson had, as alleged in the OIP, willfully violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder.[9] The Settlement Order further found that it was in the public interest to impose against Williamson a cease-and-desist order, collateral and officer-director bars with the right to apply for reentry after two years, and a $100,000 civil money penalty.[10]

In issuing the Temporary Suspension Order, we found it "appropriate and in the public interest" that Williamson be temporarily suspended from appearing or practicing before the Commission based on the Settlement Order's findings that he willfully violated the federal securities laws.[11] We stated that the temporary suspension would become permanent unless Williamson filed a petition seeking to lift it within thirty days of service of the Temporary Suspension Order, pursuant to Rule 102(e)(3)(ii).[12] 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 a hearing, or both.[13]

In his petition to lift the temporary suspension, Williamson argues, among other things, that: (1) Rule 102(e)(3)(i)(B) applies only to "attorneys," and Williamson is not an "attorney" within the meaning of that rule because he never practiced law and is not authorized to practice law in any jurisdiction; (2) the Settlement Order constitutes a "global resolution" of all claims

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5 *Id.*

6 *Id.*

7 *Id.*

8 *Brian Williamson*, Exchange Act Release No. 71364, 2014 WL 231972 (Jan. 22, 2014).

9 15 U.S.C. §§ 77q(a), 78j(b), & 80b-6(4); 17 C.F.R. §§ 240.10b-5 & 206(4)-8. *See Williamson*, 2014 WL 231972, at *1-11.

10 *Id.* at *12-13.

11 *Williamson*, 2014 WL 1603592, at *2.

12 *Id.*

13 *Id.*

against Williamson based on the underlying misconduct, and this Rule 102(e) proceeding is "an inappropriate piling on of penalties"; and (3) the public interest factors in *Steadman v. SEC*[14] weigh in favor of lifting the temporary suspension. The Office of the General Counsel ("OGC") has opposed Williamson's petition and requests that we set the matter down for a hearing.

Rule 102(e)(3)(iii) provides that, "[w]ithin 30 days after the filing of a petition [to lift a temporary suspension] in accordance with paragraph (e)(3)(ii) of this rule, the Commission shall either lift the temporary suspension, or set the matter down for hearing at a time and place designated by the Commission, or both."[15] After considering the parties' arguments in their briefs and the applicable law, we have determined to deny Williamson's petition and to set the matter down for a hearing before a law judge.[16] The Commission has already found in the Temporary Suspension Order that it was in the public interest that Williamson be temporarily suspended, and Williamson has not offered any persuasive reason to question that determination. Continuing Williamson's temporary suspension pending a hearing on the issues raised in his petition serves the public interest and protects the Commission's processes. As discussed, the Settlement Order found that Williamson willfully violated antifraud provisions of the federal securities laws by making materially false and misleading statements and omissions about OGR's valuation. Those findings, which Williamson is precluded from contesting in this Rule 102(e)(3) proceeding, justify the continuation of his suspension until it can be determined what, if any, action may be appropriate to protect the Commission's processes.[17]

Under the circumstances, we find it appropriate to continue Williamson's suspension pending the holding of a public hearing and decision by a law judge. As provided in Rule

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[14] 603 F.2d 1126 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

[15] 17 C.F.R. § 201.102(e)(3)(iii).

[16] The Commission has denied similar petitions in the recent past. *See, e.g., Virginia K. Sourlis, Esq.*, Exchange Act Release No. 69358, 2013 WL 1453371 (Apr. 10, 2013); *Stewart A. Merkin, Esq.*, Exchange Act Release No. 68981, 2013 WL 661621 (Feb. 25, 2013); *Jilaine H. Bauer, Esq.*, 2012 WL 5493356; *Mitchell Segal, Esq.*, Exchange Act Release No. 67930, 2012 WL 4458283 (Sept. 26, 2012); *Ran H. Furman*, Exchange Act Release No. 65680, 2011 WL 5231425 (Nov. 3, 2011); *Michael C. Pattison, CPA*, Exchange Act Release No. 64598, 2011 WL 2169094 (June 3, 2011); *Carl W. Jasper, CPA*, Exchange Act Release No. 64077, 2011 WL 881508 (Mar. 11, 2011); *William D. Shovers*, Exchange Act Release No. 59874, 2009 WL 1271170 (May 6, 2009); *Chris G. Gunderson, Esq.*, Exchange Act Release No. 56396, 2007 WL 2668485 (Sept. 12, 2007); *Ulysses "Thomas" Ware*, Exchange Act Release No. 51222, 2005 WL 399675 (Feb. 17, 2005); *Daniel S. Lezak*, Exchange Act Release No. 50729, 2004 WL 2721400 (Nov. 23, 2004); *Herbert M. Campbell, II*, Exchange Act Release No. 43422, 2000 WL 1482918 (Oct. 6, 2000).

[17] *See* 17 C.F.R. § 201.102(e)(3)(iv) (stating that, in any hearing held on a petition filed in accordance with Rule 102(e)(3)(ii), the petitioner may not contest any findings made against him in the underlying proceeding).

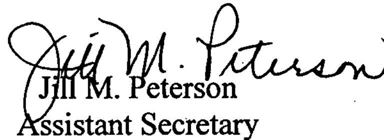
102(e)(3)(iii), we will set the matter down for a public hearing. We express no opinion as to the merits of Williamson's arguments.

Accordingly, IT IS ORDERED that this proceeding be set down for a public hearing before an administrative law judge in accordance with Commission Rule of Practice 110. As specified in Rule of Practice 102(e)(3)(iii), the hearing in this matter shall be expedited in accordance with Rule of Practice 500; it is further

ORDERED that the administrative law judge shall file an initial decision no later than 210 days from the date of service of this Order; and it is further

ORDERED that the temporary suspension of Brian Williamson, Esq., entered on April 22, 2014, remain in effect pending a hearing and decision in this matter.

By the Commission.



Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31088 / June 19, 2014

In the Matter of

Copley Fund, Inc.
5348 Vegas Drive
Suite 391
Las Vegas, Nevada 89108

(811-02815)

ORDER UNDER SECTION 6(c) OF THE INVESTMENT COMPANY ACT OF 1940 DENYING A REQUEST FOR A HEARING AND DENYING AN EXEMPTION FROM RULE 22c-1 UNDER THE ACT AND RULE 4-01(a)(1) OF REGULATION S-X

Copley Fund, Inc. ("Copley") filed an application on September 4, 2013 requesting an exemption from rule 22c-1 under the Investment Company Act of 1940 ("Act") and rule 4-01(a)(1) of Regulation S-X to permit Copley to estimate a provision for its federal income tax liability using a formula developed by Copley and described in the application.

On May 15, 2014, a notice of the filing of the application was issued (Securities Exchange Act Release No. 72173). The notice gave interested persons an opportunity to request a hearing and stated that, absent a request for a hearing that is granted by the Commission, the Commission intends to issue an order under the Act denying the application. On June 5, 2014, Copley submitted a three-sentence-long request for a hearing "on the issues raised in the Application and the Commission's preliminary responses thereto set forth in the [notice]." The request stated that "In support, the Copley Fund relies on its prior submissions, previously submitted in support of its Application, and incorporates same as if set forth at length herein."

Because Copley's hearing request did not identify any issues that the Commission had not previously considered that might warrant a hearing, the Commission is denying the hearing request. Furthermore, for the reasons stated in the notice, the Commission finds that granting the requested exemption is not necessary or appropriate in the public interest and is not consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

Accordingly,

IT IS ORDERED, under section 6(c) of the Act, that the requested exemption from rule 22c-1 under the Act and rule 4-01(a)(1) of Regulation S-X is denied.

By the Commission

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 200

[Release No. 34-72440 ; File No. S7-07-14]

RIN 3235-AL58

Freedom of Information Act Regulations: Fee Schedule, Addition of Appeal Time Frame, and Miscellaneous Administrative Changes

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is publishing for comment proposed amendments to the Commission's regulations under the Freedom of Information Act ("FOIA") to allow the Commission to collect fees that reflect its actual costs, add an appeals time frame that will create a more practical and systematic administrative process and clarify other issues in the regulations. The proposed amendments provide a formula for fees charged to FOIA requesters; incorporate a time frame in which a FOIA requester must file an appeal in the event a request or a portion thereof is denied; allow for submission of FOIA appeals by email or facsimile; and allow the Office of FOIA Services to issue responses to FOIA requests indicating that no records were located.

DATES: Comments should be received by [insert date that is 30 days from 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);

- Send an email to rule-comments@sec.gov. Please include File Number S7-07-14 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 Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-07-14. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: John Livornese, FOIA/PA Officer, Office of FOIA Services, (202) 551-3831; Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-5041.

SUPPLEMENTARY INFORMATION

1. **Purpose.**

The Commission is proposing to amend its FOIA regulations at 17 CFR 200.80 and 17 CFR 200.80e.

A. Proposed Changes to Fee Regulations

The fees the Commission charges for searching, reviewing, and duplicating records pursuant to FOIA requests are currently set forth in 17 CFR 200.80e, Appendix E--Schedule of fees for records services. The Commission believes it is appropriate to update its fee schedule for searching and reviewing records in accordance with Uniform Freedom of Information Act Fee Schedule and Guidelines promulgated by the Office of Management and Budget.[1]

The OMB Guidelines, in complying with the Freedom of Information Reform Act of 1986, require that each agency's fees be based upon its "direct reasonable operating costs of providing FOIA services."[2] The guidelines state that "[a]gencies should charge fees that recoup the full allowable direct costs they incur."[3]

OMB recognized that costs would necessarily vary from agency to agency and directed that each agency promulgate regulations specifying the charges for search, review, and duplication. The OMB Guidelines state that "agencies should charge at the salary rate[s] [i.e. basic pay plus 16 percent] of the employee[s] making the search" or, "where a homogeneous class of personnel is used exclusively . . . agencies may establish an average rate for the range of grades typically involved."[4]

The Commission's current regulation contains set rates for FOIA request search and review activities: $16/hour for grade 11 and below; and $28/hour for grade 12 and above. The Commission is proposing to revise its regulation to reflect the formula contained in the OMB Guidelines (basic pay plus 16 percent) rather than setting forth a fixed price. Moreover, the proposed regulation provides that the Commission will establish a representative rate for each of

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[1] *See* 52 FR 10011 (March 27, 1987).
[2] *Id.* at 10015.
[3] *Id.* at 10018.
[4] *Id.*

the three different groups of grades typically involved: personnel in grades SK 8 or below; personnel in grades SK 9 to 13; and personnel in grades SK 14 or above.[5] The Commission's website will contain current rates for search and review fees for each class. The rates will be updated as salaries change and will be determined by using the formula in the regulation. For the current calendar year, the fees would be assessed as follows: SK-8 or below: $29/hour; SK-9 to 13: $61/ hour; and SK-14 or above: $89/hour.[6]

In connection with this revision, the Commission is also proposing to remove the first sentence of 17 CFR 200.80(e)(1) which provides that up to one-half hour of staff time devoted to searching for and reviewing Commission records will be provided without charge. The regulation as amended will allow the Commission to charge FOIA requesters in quarter-hour increments at the rates established by reference to the OMB Guidelines. Presently, the Commission estimates the time spent processing a single FOIA request at approximately 1 ½ hours at an estimated cost of $42. If the regulations are amended to reflect the formula contained in the OMB Guidelines as discussed above, the average cost per request would increase to approximately $92.[7] This cost is estimated by utilizing the hourly rate of pay of a Washington, DC-based SK-12 employee, which is the typical employee who currently does most of the work in processing a FOIA request.

[5] As per the OMB Guidelines, fees for searches of computerized records will continue to be based on the actual cost to the Commission which includes machine and operator time. 17 CFR 200.80(e)(9)(i).

[6] The SK-8 and below rate is estimated using the maximum and minimum annual salary of a Washington, DC-based SK-6 staffer. For 2014 this is [($41,619 + $63,307)/2][1/2087 hours per year][1.16 OMB markup factor] = $29 per hour. Similarly, the SK-9 through SK-13 category is estimated by using the max and min annual salary of a Washington, DC-based SK-12 staffer, who typically does most of the work of a FOIA request. For 2014 this is [($82,037 + $138,211)/2][1/2087 hours/year][1.16 OMB markup factor] = $61/hour. Finally, the SK-14 and above category is estimated by using the max and min salary of a Washington, DC-based SK-15 supervisor. For 2014 this is [($118,743 + $200,033)/2][1/2087 hours per year][1.16 OMB markup factor] = $89/hour.

[7] All fees will be charged in accordance with the categories of FOIA requesters as set forth in 5 U.S.C. 552(a)(4)(A)(ii), 17 CFR 200.80(e)(10).

The proposed fee regulation provides, fees will not be charged under either the FOIA or the Privacy Act where the costs of collecting and processing the fee are likely to equal or exceed the amount of the fee or where the requester has met the requirements for a statutory fee waiver. The proposed language is based upon the language of 5 U.S.C. 552(a)(4)(A)(iv) (providing that no fee may be charged if the fee exceeds the costs of collecting and processing the fee). Currently, the cost of the average fee collection activity is $20, so no fee will be charged of $20 or less.

B. *Proposed Changes to FOIA Appeals Time Frames*

The FOIA requires federal agencies to notify requesters of their right to appeal any adverse determination. 5 U.S.C. 552(a)(6)(A)(i). The Commission's regulations currently provide no time frame in which a FOIA requester must file an appeal. Although the FOIA does not require agencies to establish an appeals time frame, neither does it preclude them from doing so. The proposed amendment would establish an appeals time frame of 30 days, which is appropriate in order to allow for more efficient and improved appeals processing by the Commission's Office of the General Counsel. In addition, the implementation of an appeals time frame is consistent with the practices of other federal agencies. Our staff has reviewed the practices at the 15 United States federal executive departments. Of these, seven have a FOIA appeals time frame of 30 days, five have a 60 day time frame, one has a 35 day time frame, one has a 45 day time frame and one has a 90 day time frame.[8]

C. *Submission of FOIA Appeals by Email and Facsimile*

The Commission is revising 17 CFR 200.80(d)(6)(ii) to allow appeals to be submitted by facsimile or email as well as through the mail.

[8] Independent agencies comparable to the SEC (FDIC, CFTC and FTC) have 30 day appeals time frames.

D. Responses to FOIA Requests Indicating No Records Could Be Located

The Commission's current regulations do not provide for responses to FOIA requests that indicate that no responsive records were located. The proposed amendment would make clear that a possible response to a FOIA request is that no responsive records were located.

REQUEST FOR COMMENTS

We request and encourage any interested person to submit comments on any aspect of the proposals, other matters that might have an impact on the amendments and any suggestions for additional changes. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. We urge commenters to be as specific as possible.

ECONOMIC ANALYSIS

The Commission is sensitive to the economic effects, including the costs and benefits, that result from its rules, and Section 23(a)(2) of the Exchange Act requires the Commission, in making rules pursuant to any provision of the Exchange Act, to consider among other matters the impact any such rule would have on competition. As discussed further below, the Commission preliminarily believes that the proposed rules will have a minimal economic effect.

The proposed rules are intended to help align the Commission's fees related to FOIA requests with its direct reasonable operating costs of providing FOIA services and to allow more efficient processing of requests. Although the proposed rules are unlikely to have a significant impact on the economy, the Commission believes that the rules will benefit the Commission and the public. Compared to the baseline, which includes the current fee structure outlined above, the proposed rules will permit the Commission to charge fees that more closely reflect the direct costs the Commission incurs to provide FOIA services. Additionally, the proposed rules will

provide increased flexibility to FOIA requesters by expressly permitting appeals by email and facsimile. By establishing a time frame for FOIA appeals that, in light of potential alternatives, is consistent with the practice of other federal agencies, the proposed rules will also improve efficiency in the appeal process.

The Commission recognizes, however, that the proposed rules may also impose costs. Specifically, the proposed rules may impose additional costs on individuals who wish to obtain access to Commission records and may impose a burden on requesters who would be required to appeal a decision within 30 days. But, as discussed elsewhere, the Commission believes that those costs would be insignificant. Additionally, the Commission preliminarily believes that the proposed rules will not burden competition and that any potential burden on competition imposed by the proposed rules would be appropriate in furtherance of purposes of the Exchange Act.

The Commission requests comment on all aspects of the benefits and costs of the proposal, including any anticipated impacts on competition.

REGULATORY FLEXIBILITY ACT CERTIFICATION

Section 3(a) of the Regulatory Flexibility Act of 1980 ("RFA") requires the Commission to undertake an initial regulatory flexibility analysis of the proposed rule amendments on small entities unless the Commission certifies that the proposal, if adopted, would not have a significant economic impact on a substantial number of small entities. The overwhelming majority of FOIA requests made to the Commission involve either no charge or the charges apply to just six companies, none of which appear to be small entities. Generally, increases in the average cost will be from $0 to approximately $31 for requests that take one-half hour to process and $42 to approximately $92 for those that take 1½ hours to process. Pursuant to 5

U.S.C. 605(b), the Commission certifies that the proposed amendments will not have a significant economic effect on a substantial number of small entities. The Commission requests comments regarding the appropriateness of its certification.

OTHER ADMINISTRATIVE LAW MATTERS

Because these amendments are generally rules of agency organization, procedure and practice that do not substantially affect the rights and obligations of non-agency parties, the Congressional Review Act does not apply.[9]

These amendments do not contain any collection of information requirement as defined by the Paperwork Reduction Act of 1995, as amended.[10] The Commission solicits comment on whether the proposed amendments would be "major" as defined in 5 U.S.C. 804.

STATUTORY AUTHORITY AND TEXT OF PROPOSED RULE AMENDMENTS

The amendments contained herein are being proposed under the authority set forth in 5 U.S.C. 552 and 15 U.S.C. 78d-1.

List of Subjects in 17 CFR Part 200.

Administrative practice and procedure, Freedom of information.

Text of Proposed Amendments

For the reasons stated in the preamble, the Commission proposes to amend 17 CFR part 200, subpart D as follows:

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

Subpart D—Information and Requests

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[9] 5 U.S.C. 801, et seq.

[10] 44 U.S.C. 3501-3520

1. The authority citation for part 200, subpart D, is revised to read, in part, as follows: Authority: 5 U.S.C. 552, as amended, 15 U.S.C. 77f(d), 77s, 77ggg(a), 77sss, 78m(F)(3), 78w, 80a-37, 80a-44(a), 80a-44(b), 80b-10(a), and 80b-11, unless otherwise noted.

* * * * *

2. Amend § 200.80 by:

a. Revising paragraph (d)(5)(i);

b. Revising paragraphs (d)(6)(i) and (d)(6)(ii);

c. Revising paragraph (e) introductory text; and

d. Removing the first sentence of paragraph (e)(1);

The revisions read as follows:

§ 200.80 Commission records and information.

* * * * *

(d) * * *

(5) *Initial determination; multi-track processing, and denials*--(i) Time within which to respond. When a request complies with the procedures in this section for requesting records under the Freedom of Information Act, a response shall be sent within 20 business days from the date the Office of FOIA Services receives the request, except as described in paragraphs (d)(5)(ii) and (d)(5)(iii) of this section. If that Office cannot locate any requested records, the response shall advise the requester accordingly.

* * * * *

(6) * * *

(i) *Time limits and content of appeal.* Appeals shall be clearly and prominently identified at the top of the first page with the legend "Freedom of Information Act Appeal" and shall provide the assigned request number. Copies of the request and the SEC's response, if any, should be included with the appeal. If an appeal is from an adverse decision, it must be received within thirty (30) calendar days of the date of the adverse decision. If only a portion of the decision is appealed, the requester must specify which part of the decision is being appealed. An appeal from an adverse decision should also identify the name of the deciding official, the date of the decision, and the precise subject matter of the appeal. An appeal is not perfected until the SEC receives the information identified in this paragraph (6)(i).

(ii) *How to file and address a written appeal.* The appeal must be sent to both the General Counsel and the Office of FOIA Services at 100 F Street, NE, Washington, DC 20549. The SEC accepts facsimiles (faxes) and emails as written FOIA appeals. Information regarding where to fax or email a FOIA appeal is available on the SEC's FOIA home page on the Commission's website at http://www.sec.gov/foia.shtml. A legible return address must be included with the FOIA appeal. The requester may also include other contact information, such as a telephone number and/or an email address.

* * * * *

(e) *Fees for records services.* Information pertaining to search and review services, including locating, reviewing, and making records available, attestations and copying, appears in appendix E to this subpart D, 17 CFR 200.80e. A schedule of fees is located at the Commission's website at http://www.sec.gov/foia/feesche.htm.

* * * * *

3. Amend § 200.80e by:

a. Adding an undesignated introductory paragraph; and

b. Revising the paragraph that begins, "Search and review services:".

The addition and revision read as follows:

§ 200.80e Appendix E – Schedule of fees for records services.

The requester will be charged search, review, and duplication fees according to his or her fee category. In addition, the SEC will charge the requester for any special handling or services performed in processing the request and/or appeal. Duplication fees also are applicable to records provided in response to requests made under the Privacy Act. Fees will not be charged under either the FOIA or the Privacy Act where the costs of collecting and processing the fee are likely to equal or exceed the amount of the fee or where the requester has met the requirements for a statutory fee waiver. Fees will be determined as follows:

Search and review services (review applies to commercial-use requesters only): The Commission will establish and charge average rates for the groups of grades typically involved in search and review. Those groups will consist of employees at:

(1) Grades SK-9 or below;

(2) Grades SK-10 to SK-14; and

(3) Grades SK-15 or above.

The average rates will be based on the hourly salary (i.e., basic salary plus locality payment), plus 16 percent for benefits, of employees who routinely perform those services. Fees

will be charged in quarter-hour increments. The average hourly rates are listed on the Commission's website at http://www.sec.gov/foia/feesche.htm and will be updated as salaries change.

* * * * *

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Date: June 20, 2014

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3858 / June 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15939

In the Matter of **PENN MEZZANINE PARTNERS MANAGEMENT, L.P.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Penn Mezzanine Partners Management, L.P. ("Penn Mezzanine" 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 Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

A. SUMMARY

1. These proceedings involve violations of the Advisers Act's registration requirement by Penn Mezzanine. Section 203(a) of the Advisers Act prohibits an investment adviser from using the mails or any means or instrumentality of interstate commerce in connection with its business as an investment adviser unless it is registered with the Commission or exempt from registration. Section 208(d) of the Advisers Act makes it unlawful for any person indirectly, or through or by any other person, to do any act or thing which would be unlawful for such person to do directly under the provisions of the Act or rule or regulation thereunder.

2. Effective March 30, 2012, Penn Mezzanine and TL Ventures Inc. ("TL Ventures"), a related investment adviser, each claimed to be exempt from the Advisers Act's registration requirements. However, the facts and circumstances surrounding their relationship indicate that the two advisers were under common control, were not operationally independent of each other and thus should have been integrated as a single investment adviser for purposes of the applicable registration requirement and the applicability of any exemption. Once integrated, Penn Mezzanine and TL Ventures would not have qualified for any exemption from registration and therefore should have been registered effective March 30, 2012.

3. By using the mails or any means or instrumentality of interstate commerce in connection with its business as an investment adviser and not being registered with the Commission, Penn Mezzanine, acting through or by TL Ventures, violated Sections 203(a) and 208(d) of the Advisers Act.

B. RESPONDENT

4. Penn Mezzanine is a Delaware limited partnership located in Wayne, Pennsylvania. Penn Mezzanine is not registered with the Commission as an investment adviser. Prior to March 30, 2012, Penn Mezzanine was exempt from Commission registration in reliance on Section 203(b)(3) of the Advisers Act and Rule 203-1(e) under the Advisers Act.[2] From March 29, 2012, Penn Mezzanine claimed to be an investment adviser solely to private funds with less than $150 million in regulatory assets under management and thus to be exempt under Rule 203(m)-1 under

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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] The exemption from registration formerly contained in Section 203(b)(3) was repealed effective July 21, 2011 by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), and Rule 203-1(e) in effect extended that exemption until March 30, 2012. See Rules Implementing Amendments to the Investment Advisers Act of 1940, Advisers Act Release No. 3221 (June 22, 2011), 2011 SEC LEXIS 2149.

the Advisers Act from registration as an investment adviser. It has reported to the Commission as an "exempt reporting adviser" under Section 204(a) of the Advisers Act and Rule 204-4 thereunder.[3] In its exempt reporting adviser report on Form ADV dated March 31, 2014, Penn Mezzanine reported regulatory assets under management of approximately $51 million in private capital funds.

C. BACKGROUND

Penn Mezzanine and TL Ventures Should Have Been Registered

The Advisers Claimed to Be Exempt From Registration

5. The Dodd-Frank Act repealed a prior exemption from registration under Section 203(b)(3) of the Advisers Act but mandated other exemptions. In connection with implementing the new exemptions, investment advisers that were previously exempt from registration under Section 203(b)(3) of the Advisers Act were required to be registered or file as exempt reporting advisers by March 30, 2012. On March 29, 2012, Penn Mezzanine and TL Ventures filed separate exempt reporting adviser reports on Form ADV with the Commission each claiming to be an exempt reporting adviser, and neither Penn Mezzanine nor TL Ventures registered with the Commission as an investment adviser under Section 203 of the Advisers Act. Penn Mezzanine claimed that it qualified for an exemption from registration with the Commission based on Rule 203(m)-1 under the Advisers Act because it acted solely as an adviser to private funds and had regulatory assets under management in the U.S. of less than $150 million. TL Ventures claimed that it qualified for an exemption from registration with the Commission based on Section 203(l) of the Advisers Act because it was an adviser solely to one or more venture capital funds.

The Advisers were Operationally Integrated

6. On their exempt reporting adviser reports filed with the Commission, both Penn Mezzanine and TL Ventures report that they are under common control with each other. In addition, various employees and associated persons of TL Ventures held ownership stakes in TL Ventures and in the general partner and management company entities of Penn Mezzanine; among those, two managing directors of TL Ventures held in the aggregate a majority ownership interest in TL Ventures and indirectly held in the aggregate more than a 25%, but less than a majority, ownership interest in Penn Mezzanine.

7. Penn Mezzanine and TL Ventures had several overlapping employees and associated persons, including individuals who provided investment advice on behalf of both Penn

[3] The Dodd-Frank Act created a category of advisers known as exempt reporting advisers (which generally were formerly advisers relying on the private adviser exemption contained in Section 203(b)(3), which has been repealed). Although exempt from Commission registration, exempt reporting advisers are required by Rule 204-4 under the Advisers Act to file reports with the Commission electronically on Form ADV through the IARD using the same process used by registered investment advisers.

Mezzanine and TL Ventures. For example, two of the three members of Penn Mezzanine's investment committee, which had sole and exclusive authority to approve any investment by Penn Mezzanine's fund, also served as managing directors at TL Ventures and were significantly involved in providing investment advice on behalf of TL Ventures.

8. Penn Mezzanine and TL Ventures had significantly overlapping operations without any policies and procedures designed to keep the entities separate. Marketing materials for Penn Mezzanine made reference to TL Ventures and Penn Mezzanine as being a "partnership" and referenced Penn Mezzanine's ability to leverage and benefit from this relationship, including outsourcing its back office functions to TL Ventures. In addition, Managing Directors of TL Ventures, who served on Penn Mezzanine's investment committee, solicited potential investors for Penn Mezzanine's funds, including soliciting past investors in TL Ventures' funds. Moreover, neither adviser had adequate information security policies and procedures in place to protect investment advisory information from disclosure to the other. Also, employees and associated persons of Penn Mezzanine routinely used their TL Ventures email addresses to conduct business and communicate with outside parties about and on behalf of Penn Mezzanine.

The Advisers Did Not Qualify for Exemption From Registration

9. The Commission has stated that it will treat as a single adviser two or more affiliated advisers that are separate legal entities but are operationally integrated, which could result in a requirement for one or both advisers to register.[4] Based upon the facts and circumstances, Penn Mezzanine and TL Ventures were operationally integrated and, therefore, were not eligible to rely on the claimed exemptions from registration.

10. When integrated with TL Ventures, Penn Mezzanine did not qualify for an exemption from registration with the Commission under Rule 203(m)-1 under the Advisers Act because the combined operations of Penn Mezzanine and TL Ventures exceeded $150 million in regulatory assets under management in the U.S. Accordingly, as of March 30, 2012, Penn Mezzanine should have registered with the Commission as an investment adviser under the Advisers Act.

D. VIOLATIONS

11. Section 203(a) of the Advisers Act makes it unlawful for any investment adviser, unless registered or exempt from registration, to make use of the mails or any means or instrumentality of interstate commerce in connection with its business as an investment adviser. Section 208(d) of the Advisers Act makes it unlawful for any person indirectly, or through or by any other person, to do any act or thing which would be unlawful for such person to do directly

[4] See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 at 125 (June 22, 2011) [76 FR 39645, 39680 (July 6, 2011)].

under the provisions of the Advisers Act.[5] As described above, Penn Mezzanine acted through or by TL Ventures to engage in the business of providing investment advice without registering as an investment adviser and, as a result, Penn Mezzanine willfully[6] violated Sections 203(a) and 208(d) of the Advisers Act.

REMEDIAL EFFORTS

In determining to accept the Offer, the Commission considered remedial acts that the Respondent is undertaking, including steps to reorganize operations and separate its advisory functions from TL Ventures, as well as the adoption of policies and procedures reasonably designed to ensure compliance with the applicable rules.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 203(a) of the Advisers Act, including committing or causing any such violations indirectly, or through or by any other person, as prohibited by Section 208(d) of the Advisers Act.

B. Respondent is censured.

By the Commission.

Jill M. Peterson
Assistant Secretary

5 Advisers Act Sections 203(a) and 208(d) do not require a showing of scienter.

6 A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3859 / June 20, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15940

In the Matter of **TL VENTURES INC.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against TL Ventures Inc. ("TL Ventures" 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 Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

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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.

A. SUMMARY

1. These proceedings involve violations of: (1) the Commission's "pay-to-play" rule for investment advisers by TL Ventures, an investment adviser to venture capital funds which invest in early-stage technology companies, and (2) the Advisers Act's registration requirement by TL Ventures.

2. Rule 206(4)-5, promulgated under Section 206(4) of the Advisers Act, is a prophylactic rule designed to address pay-to-play abuses involving campaign contributions made by advisers or their covered associates to government officials who are in a position to influence the selection of advisers to manage government client assets, including public pension assets. Among other things, Rule 206(4)-5 prohibits investment advisers from providing advisory services for compensation to a government client (or to an investment vehicle in which a government entity invests), for two years after the adviser or certain of its executives or employees make a campaign contribution to certain elected officials or candidates. Rule 206(4)-5 does not require a showing of quid pro quo or actual intent to influence an elected official or candidate.

3. On April 12, 2011, a covered associate[2] of TL Ventures (the "Covered Associate") made a $2,500 campaign contribution to the campaign of a candidate for Mayor of Philadelphia, PA (the "Mayoral Contribution"). The Mayor of Philadelphia appoints three of the nine members of the City of Philadelphia Board of Pensions and Retirement ("Philadelphia Retirement Board"). In addition, on November 21, 2011, the Covered Associate made a $2,000 campaign contribution to the Governor of Pennsylvania (the "Gubernatorial Contribution"). The Governor of Pennsylvania appoints six of the eleven members of the board of the Pennsylvania State Employees' Retirement System ("SERS").

4. SERS has been an investor (called a "limited partner") in two TL Ventures funds, TL Ventures IV L.P. ("TL Ventures IV") and TL Ventures V L.P. ("TL Ventures V"), since 1999 and 2000, respectively. The Philadelphia Retirement Board has been a limited partner in TL Ventures V since 2000. As limited partners, SERS and the Philadelphia Retirement Board contractually committed to invest a stated amount of money in TL Ventures' funds and they made those investments over time. Limited partners in TL Ventures' funds are generally prohibited from withdrawing their money for the life of the fund, often 10 or more years.

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[2] "Covered associates" are officers and employees of the adviser who have a direct economic stake in the business relationship with the government client. Covered associates are defined to include: (i) any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) any political action committee controlled by the investment adviser or by any of its covered associates. Under the Rule, executive officers include: (i) the president; (ii) any vice president in charge of a principal business unit, division or function (such as sales, administration or finance); (iii) any other officer of the investment adviser who performs a policy-making function; or (iv) any other person who performs similar policy-making functions for the investment adviser. Rule 206(4)-5(f)(2) and (4).

5. During the two years after the Mayoral Contribution, TL Ventures continued to provide investment advisory services to TL Ventures V and continued to receive advisory fees attributable to such services. Similarly, during the two years after the Gubernatorial Contribution, TL Ventures continued to provide investment advisory services to TL Ventures IV, in addition to TL Ventures V, and continued to receive advisory fees attributable to such services. By continuing to provide advisory services for compensation to covered investment pools invested in by the Philadelphia Retirement Board and SERS within two years after political contributions by a covered associate to government officials in a position to influence the selection of investments by those pension funds, TL Ventures violated Section 206(4) of the Advisers Act and Rule 206(4)-5 thereunder.

6. Section 203(a) of the Advisers Act prohibits an investment adviser from using the mails or any means or instrumentality of interstate commerce in connection with its business as an investment adviser unless it is registered with the Commission or exempt from registration. Section 208(d) of the Advisers Act makes it unlawful for any person indirectly, or through or by any other person, to do any act or thing which would be unlawful for such person to do directly under the provisions of the Act or rule or regulation thereunder.

7. Effective March 30, 2012, TL Ventures and Penn Mezzanine Partners Management, L.P. ("Penn Mezzanine"), a related investment adviser, each claimed to be exempt from the Advisers Act's registration requirements. However, the facts and circumstances surrounding their relationship indicate that the two advisers were under common control, were not operationally independent of each other and thus should have been integrated as a single investment adviser for purposes of the applicable registration requirement and the applicability of any exemption. Once integrated, TL Ventures and Penn Mezzanine would not have qualified for any exemption from registration and therefore should have been registered effective March 30, 2012.

8. By using the mails or any means or instrumentality of interstate commerce in connection with its business as an investment adviser and not being registered with the Commission, TL Ventures, acting through or by Penn Mezzanine, violated Sections 203(a) and 208(d) of the Advisers Act.

B. RESPONDENT

9. TL Ventures is a Delaware corporation located in Wayne, Pennsylvania. TL Ventures is not registered with the Commission as an investment adviser. Prior to March 30, 2012, TL Ventures was exempt from Commission registration in reliance on Section 203(b)(3) of the Advisers Act and Rule 203-1(e) under the Advisers Act.[3] From March 29, 2012, TL Ventures

[3] The exemption from registration formerly contained in Section 203(b)(3) was repealed effective July 21, 2011 by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), and Rule 203-1(e) in effect extended that exemption until March 30, 2012. See Rules Implementing Amendments to the Investment Advisers Act of 1940, Advisers Act Release No. 3221 (June 22, 2011), 2011 SEC LEXIS 2149.

claimed to be an investment adviser solely to one or more venture capital funds and thus to be exempt under Section 203(l) of the Advisers Act from registration as an investment adviser. It has reported to the Commission as an "exempt reporting adviser" under Section 204(a) of the Advisers Act and Rule 204-4 thereunder.[4] In its exempt reporting adviser report on Form ADV dated March 31, 2014, TL Ventures reported regulatory assets under management of approximately $178 million in venture capital funds.

C. BACKGROUND

TL Ventures is an Adviser to "Covered Investment Pools"

10. TL Ventures is an adviser to venture capital funds which invest in early-stage technology companies. TL Ventures raised its last venture capital fund in 2008. TL Ventures acted as the investment adviser to several venture capital funds, including TL Ventures IV and TL Ventures V, both of which constitute "covered investment pools" as defined in Advisers Act Rule 206(4)-5(f)(3) because they would be investment companies under Section 3(a) of the Investment Company Act of 1940 but for the exclusion from the definition of investment company provided by Section 3(c)(1) of the Investment Company Act of 1940. The funds have terms of 10 years, with the possibility of two one-year extensions following the initial term if approved by a majority-in-interest of the limited partners in the fund.

Investments in TL Ventures Funds by SERS and the Philadelphia Retirement Board

11. In 1999, SERS committed to invest, and subsequently invested, $35 million of its public pension money in TL Ventures IV. In addition, in 2000, SERS committed to invest, and subsequently invested, $40 million of its public pension money in TL Ventures V.

12. In 2000, the Philadelphia Retirement Board committed to invest, and subsequently invested, $10 million of its public pension money in TL Ventures V.

13. Both TL Ventures IV and TL Ventures V have been in wind down mode since 2010 and 2012, respectively. While these funds are in wind down mode, SERS continues to be a limited partner of TL Ventures IV and TL Ventures V, and the Philadelphia Retirement Board continues to be a limited partner of TL Ventures V.

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4 The Dodd-Frank Act created a category of advisers known as exempt reporting advisers (which generally were formerly advisers relying on the private adviser exemption contained in Section 203(b)(3), which has been repealed). Although exempt from Commission registration, exempt reporting advisers are required by Rule 204-4 under the Advisers Act to file reports with the Commission electronically on Form ADV through the IARD using the same process used by registered investment advisers.

Campaign Contributions to Government Officials

14. On April 12, 2011, the Covered Associate made a $2,500 campaign contribution to a candidate for Mayor of Philadelphia, Pennsylvania. In addition, on November 21, 2011, the Covered Associate made a $2,000 campaign contribution to the Governor of Pennsylvania.

15. Both candidates had the ability to influence the selection of investment advisers for their respective public pension funds. The Mayor of Philadelphia has authority to appoint the City's Director of Finance, Managing Director and City Solicitor. Each of these city officials serves as a member of the nine member Philadelphia Retirement Board. The Philadelphia Retirement Board has influence over the retirement fund's investments and the selection of investment advisers and pooled investment vehicles for the fund. The Governor of Pennsylvania has authority to appoint six members of the eleven member SERS board. The SERS board has influence over investments by the SERS pension fund and the selection of investment advisers and pooled investment vehicles for the fund.

TL Ventures Continues to Receive Compensation From SERS and the Philadelphia Retirement Fund

16. Advisers Act Rule 206(4)-5(a)(1) prohibits any investment adviser registered with the Commission, investment adviser required to be registered with the Commission, foreign private adviser, or exempt reporting adviser from providing investment advisory services for compensation to a "government entity"[5] within two years after a contribution to an "official" [6] of

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[5] A "government entity" means any state or political subdivision of a state, including: (i) any agency, authority, or instrumentality of the state or political subdivision; (ii) a pool of assets sponsored or established by the state or political subdivision or any agency, authority or instrumentality thereof, including, but not limited to a "defined benefit plan" as defined in the Internal Revenue Code, or a state general fund; (iii) a plan or program of a government entity; and (iv) officers, agents, or employees of the state or political subdivision or any agency, authority or instrumentality thereof, acting in their official capacity. Rule 206(4)-5(f)(5).

[6] "Official" includes any person who, at the time of the relevant contribution, was an incumbent, candidate or successful candidate for elective office of a government entity if the office is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity or has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of an investment adviser by a government entity. Rule 206(4)-5(f)(6). If the governor of a state can appoint at least part of a state pension fund's board, the governor is considered to be an official of the government entity. Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 3043 at 44 n.143 (July 1, 2010)("Adopting Release")("For example, a state may have a pension fund whose board of directors, which has authority to hire an investment adviser, is constituted, at least in part, by appointees of the governor and members of the state legislature. In such circumstances, the governor and the members of the state legislature serving on the board would be officials of the government entity"). The Adopting Release cites as an example the Pennsylvania Public School Employees' Retirement Board, of which the governor can appoint two of the six board members. Id.

a government entity made by the investment adviser or any "covered associate" of the investment adviser. Advisers Act Rule 206(4)-5 includes a provision that applies the prohibitions of the rule to investment advisers, including exempt reporting advisers that manage assets of a government entity through covered investment pools such as hedge funds, private equity funds, venture capital funds and collective investment trusts.[7] Advisers Act Rule 206(4)-5 does not require a showing of *quid pro quo* or actual intent to influence an elected official or candidate.

17. As public pension plans, the Philadelphia Retirement Board and SERS were "government entities" as defined in Advisers Act Rule 206(4)-5(f)(5). The contributor was a "covered associate" of TL Ventures as defined in Advisers Act Rule 206(4)-5(f)(2). The candidates who received the contributions were both "officials" (as defined in Advisers Act Rule 206(4)-5(f)(6)) of government entities because their respective offices had authority to appoint members who could influence the hiring of investment advisers by the respective government entities.

18. Under Advisers Act Rule 206(4)-5, the Mayoral Contribution triggered a two-year "time-out" on TL Ventures' receiving compensation for advisory services from the Philadelphia Retirement Board. During the two years after the April 2011 Mayoral Contribution, TL Ventures continued to receive advisory fees attributable to the investment of the Philadelphia Retirement Board in TL Ventures V.[8]

19. Under Advisers Act Rule 206(4)-5, the Gubernatorial Contribution triggered a two-year "time out" on TL Ventures' receiving compensation for advisory services from SERS. During the two years after the November 2011 Gubernatorial Contribution, TL Ventures continued to receive advisory fees attributable to the investment of SERS in TL Ventures IV and V.

TL Ventures and Penn Mezzanine Should Have Been Registered

The Advisers Claimed to Be Exempt From Registration

20. The Dodd-Frank Act repealed a prior exemption from registration under Section 203(b)(3) of the Advisers Act but mandated other exemptions. In connection with implementing the new exemptions, investment advisers that were previously exempt from registration under Section 203(b)(3) of the Advisers Act were required to be registered or file as exempt reporting advisers by March 30, 2012. On March 29, 2012, TL Ventures and Penn Mezzanine filed separate

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[7] Prior to the implementation of the Dodd-Frank Act, Rule 206(4)-5 applied to, among others, advisers relying on the exemptions from registration previously available under Section 203(b)(3) of the Advisers Act, which was repealed.

[8] Rule 206(4)-5 applies to investment advisers even if the government entity was already invested in the covered investment pool at the time of the contribution. Adopting Release at 44 n.130 ("[T]his deterrent effect is the basis for our view that the two-year time out should not apply only to 'new business'…").

exempt reporting adviser reports on Form ADV with the Commission each claiming to be an exempt reporting adviser, and neither TL Ventures nor Penn Mezzanine registered with the Commission as an investment adviser under Section 203 of the Advisers Act. TL Ventures claimed that it qualified for an exemption from registration with the Commission based on Section 203(l) of the Advisers Act because it was an adviser solely to one or more venture capital funds. Penn Mezzanine claimed that it qualified for an exemption from registration with the Commission based on Rule 203(m)-1 under the Advisers Act because it acted solely as an adviser to private funds and had regulatory assets under management in the U.S. of less than $150 million.

The Advisers were Operationally Integrated

21. On their exempt reporting adviser reports filed with the Commission, both TL Ventures and Penn Mezzanine report that they are under common control with each other. In addition, various employees and associated persons of TL Ventures held ownership stakes in TL Ventures and in the general partner and management company entities of Penn Mezzanine; among those, the Covered Associate and a managing director of TL Ventures held in the aggregate a majority ownership interest in TL Ventures and indirectly held in the aggregate more than a 25%, but less than a majority, ownership interest in Penn Mezzanine.

22. TL Ventures and Penn Mezzanine had several overlapping employees and associated persons, including individuals who provided investment advice on behalf of both TL Ventures and Penn Mezzanine. For example, two of the three members of Penn Mezzanine's investment committee, which had sole and exclusive authority to approve any investment by Penn Mezzanine's fund, also served as managing directors at TL Ventures and were significantly involved in providing investment advice on behalf of TL Ventures.

23. TL Ventures and Penn Mezzanine had significantly overlapping operations without any policies and procedures designed to keep the entities separate. Marketing materials for Penn Mezzanine made reference to TL Ventures and Penn Mezzanine as being a "partnership" and referenced Penn Mezzanine's ability to leverage and benefit from this relationship, including outsourcing its back office functions to TL Ventures. In addition, Managing Directors of TL Ventures, who served on Penn Mezzanine's investment committee, solicited potential investors for Penn Mezzanine's funds, including soliciting past investors in TL Ventures' funds. Moreover, neither adviser had adequate information security policies and procedures in place to protect investment advisory information from disclosure to the other. Also, employees and associated persons of Penn Mezzanine routinely used their TL Ventures email addresses to conduct business and communicate with outside parties about and on behalf of Penn Mezzanine.

The Advisers Did Not Qualify for Exemption From Registration

24. The Commission has stated that it will treat as a single adviser two or more affiliated advisers that are separate legal entities but are operationally integrated, which could result

in a requirement for one or both advisers to register.[9] Based upon the facts and circumstances, TL Ventures and Penn Mezzanine were operationally integrated and, therefore, were not eligible to rely on the claimed exemptions from registration.

25. When integrated with Penn Mezzanine, TL Ventures did not qualify for an exemption from registration with the Commission under Section 203(l) of the Advisers Act because it was not an adviser solely to venture capital funds. Accordingly, as of March 30, 2012, TL Ventures should have registered with the Commission as an investment adviser under the Advisers Act.

D. VIOLATIONS

26. As a result of the conduct described above, TL Ventures willfully[10] violated Section 206(4) of the Advisers Act and Rule 206(4)-5 thereunder, which makes it unlawful for any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under Section 203(b)(3) of the Advisers Act, or that is an exempt reporting adviser, to provide investment advisory services for compensation to a government entity within two years after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser.

27. Section 203(a) of the Advisers Act makes it unlawful for any investment adviser, unless registered or exempt from registration, to make use of the mails or any means or instrumentality of interstate commerce in connection with its business as an investment adviser. Section 208(d) of the Advisers Act makes it unlawful for any person indirectly, or through or by any other person, to do any act or thing which would be unlawful for such person to do directly under the provisions of the Advisers Act.[11] As described above, TL Ventures acted through or by Penn Mezzanine to engage in the business of providing investment advice without registering as an investment adviser and, as a result, TL Ventures willfully violated Sections 203(a) and 208(d) of the Advisers Act.

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[9] See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 at 125 (June 22, 2011) [76 FR 39645, 39680 (July 6, 2011)].

[10] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

[11] Advisers Act Sections 203(a) and 208(d) do not require a showing of scienter.

REMEDIAL EFFORTS

In determining to accept the Offer, the Commission considered remedial acts that the Respondent is undertaking, including steps to reorganize operations and separate its advisory functions from Penn Mezzanine, as well as the adoption of policies and procedures reasonably designed to ensure compliance with the applicable rules.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 203(a) of the Advisers Act, including committing or causing any such violations indirectly, or through or by any other person, as prohibited by Section 208(d) of the Advisers Act, and shall cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-5 thereunder.

B. Respondent is censured.

C. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of $256,697 and prejudgment interest of $3,197 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the 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 TL Ventures Inc. as the Respondent in these proceedings, the file number of these proceedings, a

copy of which cover letter and money order or check shall be sent to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, MA 02110.

D. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $35,000 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 TL Ventures Inc. as the Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, MA 02110.

By the Commission.

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 24, 2014

In the Matter of **BioMedical Technology Solutions Holdings, Inc.,** **Chaolei Marketing and Finance Company,** **Clear-Lite Holdings, Inc.,** **Encompass Group Affiliates, Inc.** **(n/k/a Re-Act Enterprises, Inc.),** **Hydron Technologies, Inc.,** **Sun American Bancorp, and** **XenaCare Holdings, Inc.** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of BioMedical Technology Solutions Holdings, 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 Chaolei Marketing and Finance Company 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 Clear-Lite Holdings, Inc. because it has not filed any periodic reports since the period ended January 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Encompass Group Affiliates, Inc. (n/k/a Re-Act Enterprises, 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 Hydron Technologies, 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 Sun American Bancorp 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 XenaCare Holdings, Inc. because it has not filed any periodic reports since the period ended March 31, 2011.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed 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 June 24, 2014, through 11:59 p.m. EDT on July 8, 2014.

By the Commission.

Jill M. Peterson
Assistant Secretary

34UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72451 / June 24, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15941

In the Matter of BioMedical Technology Solutions Holdings, Inc., Chaolei Marketing and Finance Company, Clear-Lite Holdings, Inc., Encompass Group Affiliates, Inc. (n/k/a Re-Act Enterprises, Inc.), Hydron Technologies, Inc., Sun American Bancorp, and XenaCare Holdings, Inc. Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS[1]

1. BioMedical Technology Solutions Holdings, Inc. ("BMTL") (CIK No. 1443062) is a Colorado corporation located in Southbury, Connecticut with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BMTL 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 $776,913 for the prior nine months. As of June 20, 2014, the common stock of BMTL was quoted on OTC Link

[1]The short form of each issuer's name is also its stock symbol.

operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Chaolei Marketing and Finance Company ("CHFK") (CIK No. 1213788) is a dissolved Florida corporation located in Miami Shores, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CHFK 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 $119,414 for the prior nine months. As of June 20, 2014, the common stock of CHFK was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Clear-Lite Holdings, Inc. ("CLRH") (CIK No. 1412299) is a revoked Nevada corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CLRH 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 $756,251 for the prior six months. As of June 20, 2014, the common stock of CLRH was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Encompass Group Affiliates, Inc. (n/k/a Re-Act Enterprises, Inc.) ("ECGA") (CIK No. 1100820) is a dissolved Florida corporation located in Lawrenceville, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ECGA 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 $9,422,000 for the prior nine months. As of June 20, 2014, the common stock of ECGA was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Hydron Technologies, Inc. ("HTEC") (CIK No. 28146) is a New York corporation located in Saint Petersburg, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HTEC 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 $61,484 for the prior nine months. As of June 20, 2014, the common stock of HTEC 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. Sun American Bancorp ("SAMB") (CIK No. 1042521) is a void Delaware corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SAMB 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 consolidated net loss of $36,013,779 for the prior nine months. As of June 20, 2014, the common stock of SAMB was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. XenaCare Holdings, Inc. ("XCHO") (CIK No. 1384356) is a Florida corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). XCHO 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 $181,266 for the prior three months. As of June 20, 2014, the common stock of XCHO 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)].

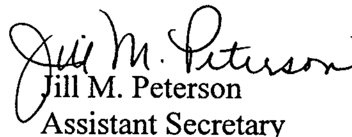
If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against 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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72456 / June 24, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15942

In the Matter of Cepheus Acquisition Corp., China Aluminum Foil, Inc., China Integrated Energy, Inc., Engchow Education Corporation, and Pixtel Group Ltd., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Cepheus Acquisition Corp., China Aluminum Foil, Inc., China Integrated Energy, Inc., Engchow Education Corporation, and Pixtel Group Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Cepheus Acquisition Corp. (CIK No. 1491828) is a void Delaware corporation located in Tel Aviv, Israel with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cepheus Acquisition Corp. 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 $52,139 since the company's August 12, 2010 inception.

2. China Aluminum Foil, Inc. (CIK No. 1483058) is a revoked Nevada corporation located in Zhengzhou City, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Aluminum Foil, Inc. 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.

3. China Integrated Energy, Inc. (CIK No. 1070045) is a delinquent Delaware corporation located in Xi'an, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(b). China Integrated Energy, Inc. 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, 2011. As of June 12, 2014, the company's stock (symbol "CBEH) was quoted on the over-the-counter markets on an unsolicited basis only and was not eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Engchow Education Corporation (CIK No. 1516510) is a void Delaware corporation located in Guangzhou, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Engchow Education Corporation 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 $92,829 since the company's February 1, 2011 inception.

5. Pixtel Group Ltd. (CIK No. 1502638) is a void Delaware corporation located in Kowloon, Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pixtel Group Ltd. 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 $45,670 since the company's July 19, 2010 inception.

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].

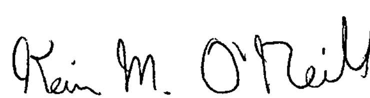
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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.



Kevin M. O'Neill
Deputy Secretary

美利坚合众国

证券交易委员会

1934 年证券交易法
发行编号 72456 / June 24, 2014

行政程序
文档编号 3-15942

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关于

Cepheus Acquisition Corp.，
中国铝箔有限公司（China Aluminum Foil, Inc.），
中国综合能源股份有限公司(China Integrated Energy Inc.)，
美洲鹰教育集团有限公司(Engchow Education Corporation) 和
Pixtel Group Ltd.,

答辩人

</td><td>

依据《1934 年证券交易法》第 12 条 (j) 款启动行政程序的指令和听证通知书

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第一部分

证券交易委员会（“委员会”）认为，为保护投资者而依据《1934 年证券交易法》（“交易法”）第 12 条 (j) 款在此向答辩人 Cepheus Acquisition Corp.，中国铝箔有限公司 (China Aluminum Foil, Inc.)、美洲鹰教育集团有限公司（Engchow Education Corporation）和 Pixtel Group Ltd. 启动公共行政程序是必要且适当的。

第二部分

经过调查，执法司指控如下：

答辩人

1. Cepheus Acquisition Corp.（CIK 编号 1491828）是一家位于以色列特拉维夫的无效的特拉华州公司，依据交易法第 12 条（g）款在委员会登记了一类证券。Cepheus Acquisition Corp. 怠于向委员会提交定期申报，自提交了截至 2011 年 9

月 30 日的表 10-Q，报告自 2010 年 8 月 12 日，公司净亏损为 52,139 美元后，其未再提交任何定期申报。

2. 中国铝箔有限公司（China Aluminum Foil, Inc. CIK 编号 1483058）是一家位于中国郑州的已被吊销的内华达州公司，依据交易法第 12 条（g）款在委员会登记了一类证券。中国铝箔有限公司怠于向委员会提交定期申报，自提交了截至 2011 年 9 月 30 日的表 10-Q，其未再提交任何定期申报。

3. 中国综合能源股份有限公司（CIK 编号 1070045）是一家位于中国西安的特拉华州公司，依据交易法第 12 条 (b) 款在委员会登记了一类证券。中国综合能源股份有限公司怠于向委员会提交定期申报，自提交了截至 2011 年 12 月 31 日的表 10-K。截至 2014 年 6 月 12 日，公司股票（代码为“CBEH”）在 OTC 市场仍主动提供报价，不符合交易法 15c2-11(f)(3) 规则中“捎带”(piggyback) 例外的资格。

4. 美洲鹰教育集团有限公司（Engchow Education Corporation，CIK 编号 1516510）是一家位于中国广州的无效的特拉华州公司，依据交易法第 12 条 (g) 款在委员会登记了一类证券。美洲鹰教育集团有限公司怠于向委员会提交定期申报，自提交了截至 2011 年 9 月 30 日的表 10-Q，报告称自 2011 年 2 月 1 日起，公司净亏损为 92,829 美元后，其未再提交任何定期申报。

5. Pixtel Group Ltd.（CIK 编号 1502638）是一家位于香港九龙的无效的特拉华州公司，依据交易法第 12 条 (g) 款在委员会登记了一类证券。Pixtel Group Ltd. 怠于向委员会提交定期申报，自提交了截至 2011 年 9 月 30 日的表 10-Q，报告称自 2010 年 7 月 19 日，公司的净亏损为 45,670 美元后，其未再提交任何定期申报。

B. 怠于提交定期申报

6. 如上文详述， 所有答辩人均怠于向委员会定期申报，已经多次不履行其按时提交定期申报的义务，且对委员会公司财务部门发出的违规告知函未能给予应有的注意，或者由于其未按照委员会规则保持一个有效的文件收发地址，而没有收到上述函件。

7. 交易法第 13 条 (a) 款及据此颁布的规则要求，依交易法第 12 条登记的证券发行人，应向委员会定期申报当前准确信息，即使该登记是在第 12 条 (g) 款下自动形成的。具体来说，规则 13a-1 要求发行人提交年度报告，规则 13a-13 要求国内发行人提交季度报告。

8. 基于以上原因，答辩人违反了交易法第 13 条 (a) 款及规则 13a-1 和/或 13a-13。

第三部分

鉴于执法司提出的指控，委员会认为，为保护投资者而提请裁决公共行政程序是必要且适当的：

A. 本文第二部分的指控是否属实以及，与此相关的，给答辩人就上述指控提出任何抗辩的机会；和，

B. 为保护投资者而对本文第二部分认定的答辩人、交易法规则 12b-2 或 12g-3 项下的任何继承者、以及任何答辩人的任何新的公司，依交易法第 12 条所登记的每一类证券，予以不超过十二个月的暂停或者撤销登记，是否必要且适当。

第四部分

兹指令，在依委员会《行为规范》第 110 条 [17 C.F.R. § 201.110] 下达进一步指令来任命行政法法官之前，将在指定的时间和地点举行公开听证，对本文第三部分所述问题进行取证。

兹进一步指令，根据委员会《行为规范》第 220 条 (b) 款 [17 C.F.R. §201.220(b)]，答辩人应在本指令送达后十 (10) 日内提交对于本指令所述指控的答辩。

依据委员会《行为规范》第 155 条 (a) 款、第 220 条 (f) 款、第 221 条 (f) 款、以及第 310 条 [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), 201.310]，如果答辩人在被正式通知后未能提交该等答辩或者未能出席听证，那么答辩人、交易法规则 12b-2 或 12g-3 项下的任何继承者、以及任何答辩人的任何新的公司，会被视为缺席听证，且在审议本指令时结果会对他们不利，本指令所述指控可能会被裁决属实。

本指令须当面，或通过证实、登记，或经特快专递，或通过委员会《行为规范》允许的其他方式，立即送达答辩人。

进一步指令，依据委员会《行为规范》第 360 条 (a) 款 (2) 项 [17 C.F.R. §201.360(a)(2)]，行政法法官应在不迟于本指令送达之日起第 120 天作出初步裁决。

在无适当豁免的情况下，任何参与行使本次或事实上与之相关的任何调查或控诉职能的委员会高级职员或雇员，不得被允许参加或建言对本次事件的裁决，除非是经通知作为本次程序的证人或律师。本次程序不属于《行政程序法》第 551 条所指的"规则制定"，本程序不受第 553 条所限制，任何最终的委员会行动生效日期不得予以延迟。

委员会发布。

Jill M. Peterson
助理秘书

送达清单

委员会《行为规范》规定，秘书或经委员会正式授权的其他职员，应将依据《1934年证券交易法》第 12 条 (j) 款启动行政程序的指令和听证通知书的副本（简称 "指令"），送达答辩人及其法定代理人。

所附指令已被送至如下各方和其它有权知晓的人士：

Brenda P. Murray 法官
首席行政法法官
证券交易委员会
100 F St., N.E.
Washington, DC 20549-2557

Neil J. Welch, Jr., Esq.
执法司
证券交易委员会
100 F St., N.E.
Washington, DC 20549-6010

通过国际优先特快专递送达：
Cepheus Acquisition Corp.
1 号 Karlibach 街
特拉维夫，以色列 L3

通过传票送达员送达：
中国铝箔有限公司 (China Aluminum Foil, Inc.)
转交 CSC Services of Nevada, Inc.
注册代理人
2215-b Renaissance Dr.
Las Vegas, NV 89119

根据《海牙公约》送达：
中国综合能源股份有限公司 (China Integrated Energy, Inc.)
10 层，西部国际广场
高新路 2 号
中国陕西省西安

通过《海牙公约》送达：
美洲鹰教育集团有限公司（Engchow Education Corporation）
4705 新都会广场
天河，天河北路 183 号
中国广州，邮编 610000

通过国际优先特快专递送达：
Pixtel Group Ltd.
鸿泰，13 层，1 号房间
工业大厦
鸿图路 37 号
香港九龙，F4 0000

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9604 / June 24, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72461 / June 24, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3862 / June 24, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31096 / June 24, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15943

In the Matter of **DAVID J. MONTANINO,** **Respondent.**	:	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203 (f) AND (k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and (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 David J. Montanino ("Montanino" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

These proceedings arise out of a fraud and misappropriation scheme conducted by Montanino and his now-deceased business partner. From February 2010 to June 2011, Montanino and his partner raised and lost, or misappropriated, at least $794,000 of investor funds through two private placement offerings. Montanino and his business partner operated the scheme through American Private Equity, LLC ("APE"), an investment fund that purported to invest in a portfolio of other investment funds to which it also served as unregistered investment adviser; Calibourne Capital Management, LLC ("Calibourne"), a state-registered investment adviser; and American Private Fund I, LP ("APF"), an investment fund in APE's supposed portfolio.

Specifically, Montanino deceived an advisory client, who invested in APF, about the amount of assets under management, the management of account assets, risks, losses, and liquidity. Montanino, with his business partner, also devised and implemented a scheme to solicit investors and advise them to invest in APE, a fund secretly designed to misappropriate investor funds. Among other things, Montanino prepared marketing documents describing the investment strategy and expected returns: through Calibourne, APE would manage $300 to $400 million within one year and sell APE within three years, generating returns of seven to ten times of capital. The investment strategy centered on Montanino running a highly profitable investment adviser, Calibourne, through which he would recruit and supervise investment professionals and successfully manage money. But Montanino had no relevant experience and no realistic expectation of implementing the investment strategy. Montanino also misrepresented his investment experience in APE's marketing documents, falsely claiming that he had provided investment management services for a client base with over $1 billion in assets and had fifteen years of investment management experience for high-net worth clients. Despite the misrepresentations made in the marketing materials and also during oral presentations in which he participated, Montanino (and his business partner) used APE investors' money for personal benefit rather than to implement the supposed investment strategy. Based on this conduct, Montanino willfully violated Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Advisers Act Sections 206(1), (2), and (4) and Rule 206(4)-8 thereunder, and willfully aided and abetted, and caused APE's violations of Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1) and (2).

A. RESPONDENT

1. Montanino, age 42, lives in East Patchogue, New York. Montanino served as sole officer and director, including Chief Compliance Officer, of Calibourne; senior managing director of APE; and portfolio manager of APF. Montanino was associated with state-registered investment adviser Calibourne until September 4, 2011, held Series 7, 63, and 65 licenses, and last associated with a registered broker-dealer in 2008. Between July 1995 and October 2008, Montanino was at various times associated with over ten registered broker-dealers

and investment advisers. The Financial Industry Regulatory Association administratively terminated Montanino's registration for failing to meet continuing education requirements for two years.

B. RELATED ENTITIES

2. APE, formed in March 2005, purported to be an investment fund that invested its assets in a portfolio of other investment funds to which it also served as unregistered investment adviser. Montanino and his business partner operated APE from offices in Los Angeles, California.

3. APF, formed in November 2009, was an investment fund in APE's supposed portfolio of funds. Montanino and his business partner operated it from APE's offices.

4. Calibourne, formed in March 2005, is a Delaware limited liability company. Montanino and, through APE, his business partner controlled Calibourne and operated it out of APE's offices in Los Angeles, California. Calibourne registered as a California investment adviser on August 5, 2005, but lost that status on March 6, 2006 after failing to pay renewal fees. In July 2010, Calibourne reapplied for registration as a California investment adviser, which became effective on January 26, 2011, but terminated its status on September 4, 2011.

C. BACKGROUND

5. In March 2005, Montanino and his business partner formed affiliated private investment firms, Calibourne and APE, promoting APE to prospective investors as a Calibourne-advised investment fund of other investment funds. Montanino contemporaneously registered Calibourne with California's Department of Corporations (now known as the Department of Business Oversight, Division of Corporations), as an investment adviser owned in part by APE. About six months later, Montanino disassociated from APE for unexplained reasons, allowed Calibourne's registration to lapse, and abandoned at least one investor he solicited during that time who expressed concerns to Montanino about the legitimacy and suitability of her APE investment.

6. Beginning in October 2005, Montanino worked as a customer relationship representative at a brokerage firm. After resigning from the firm in October 2008, Montanino remained unemployed for over a year.

7. In about December 2009, Montanino returned to APE as a senior managing director of the firm and helped launch an APE portfolio fund, APF. In February 2010, Montanino raised at least $299,000 of investor funds for APF in exchange for a passive limited partnership interest in the fund. APF collapsed a short time later, in May 2010, after its broker-dealer forced the fund to liquidate assets to satisfy outstanding liquidity-based demands generated by excessive margin transactions.

8. After the collapse of APF, Montanino and his business partner focused on soliciting investors for APE and developed a strategy – financing Calibourne's operations – through which to manage APE investors' funds. As part of this plan, in July 2010, Montanino filed an application to re-register Calibourne as a California investment adviser and, with his partner, promoted the financing of Calibourne's operations as APE's latest investment model. Between July 2010 and April 2011, Montanino and his partner raised at least $485,000 for APE from five investors in exchange for passive limited membership interests in APE, and misappropriated nearly all of it.

9. Montanino prepared materially false and misleading APF and APE marketing documents and reports containing investment advice and knew that his partner intended to and did distribute those documents to investors.

D. MONTANINO'S APF-RELATED MISCONDUCT

10. In about February 2010, Montanino solicited APF's first investor, exploiting a pre-existing relationship he had developed with her while working as a customer relationship representative at a brokerage firm, where she maintained an IRA account. Montanino approached the then-potential investor where she worked and asked her to invest in APE's newest fund, APF, without any charge on principal because she was his "friend." She transferred $299,000 to APF's escrow account on February 26, 2010, expecting to pay only performance fees as Montanino represented.

11. Montanino did not provide his client with an offering memorandum setting forth the terms of her APF investment. Instead, Montanino provided only the signature pages to a subscription agreement, wire instructions, and a brochure called "APF Stock Market Outlook and Analysis" having nothing to do with the investment's terms. In executing the signature pages, the investor chose to invest in APF's "Series B" class, which Montanino represented as bearing moderate to low risk. APF's offering documents, although not provided to the investor, confirm that "Series B" interests bore moderate to low risk.

Deceptive Conduct Concerning Assets and Account Management

12. In soliciting the APF investor, Montanino misrepresented the amount of assets he managed and his authority to personally manage her money. *First*, Montanino told his soon-to-be client, when he approached her in February 2010, that he managed multi-million dollar accounts in connection with his APE employment. But neither APE nor APF had any assets at that time. In fact, APE's only bank account was overdrawn by $2,449 on the day the investor transferred her money.

13. *Second*, before agreeing to entrust money to his care, Montanino's client sought and obtained Montanino's explicit oral assurance that he personally would manage her investment. In promising he would personally manage her investment, Montanino failed to disclose that he had no actual experience managing client assets. Moreover, Montanino was not able to manage the investor's money at the time of his promise because he did not have (or ever obtain) access to APF's bank account, and he did not obtain trading authority over APF's brokerage account until March 19, 2010, or about three weeks after she invested. By then,

Montanino's partner had already leveraged the investor's money by about 104 percent through risky margin transactions.

14. Even after obtaining trading authority, Montanino failed to act in his client's best interests, compounding his explicit promise to personally oversee her investment. Despite receiving near-daily emails from APF's broker-dealer advising of margin and risk calls, attaching reports analyzing the bases for those calls, and alerting Montanino to the fact that – at minimum – the fund was rapidly losing liquidity, Montanino did not take steps to institute liquidity safeguards, satisfy the margin and risk calls, or stop the trading activity triggering them.

15. Montanino did not disclose to his client that his partner executed trades on her (or APF's) behalf until several weeks after APF's broker-dealer shut down APF's account. Even then, Montanino falsely told the investor during a phone call that he personally generated positive returns on behalf of her account during the first month after she invested, or March 2010. In fact, Montanino did not have formal authorization to trade in the brokerage account during most of that month and, by the time he did, his partner had already exposed her investment to substantial risks that Montanino took no steps to cure or disclose.

Deceptive Conduct Concerning Risky Trades, Losses, and Liquidity

16. After his client subscribed in APF, Montanino engaged in a pattern of conduct inconsistent with that of a fiduciary, dodging the investor's attempts to obtain even basic account information and concealing facts about three important attributes of her investment: risky trading activities, investment losses, and fund liquidity.

17. On April 13, 2010, Montanino's client asked him by email for performance figures and for "some kind of proof where the money is." By then, Montanino had trading authority over APF's brokerage account for nearly a month, and knew from nearly a dozen emails and reports sent to him of repeated margin and risk-based calls triggered by stress tests the broker conducted at both the security and portfolio level. Montanino had not explained to the investor the concept of margin or its associated risks, or told her that APF might engage in margin trading.

18. Despite these facts, Montanino failed to provide his client with any information about the state or even whereabouts of her investment, responding to her April 13 email that "the portfolio value is being calculated and should be available in a week or two."

19. On April 22, 2010, Montanino's partner emailed him a statement prepared by the fund's administrator, dated March 19, 2010, concerning his client's subscription. Although the March 19 statement acknowledged the date and amount of her investment, it lacked any substantive information about performance. Regardless, Montanino did not email (or otherwise provide) it to his client until May 5, 2010 – thirteen days after obtaining it from his partner.

20. On receipt of Montanino's May 5 email, his client responded by confirming her expectation that Montanino would pay "personal attention" to her account and again asked for performance information. Montanino did not answer.

21. On May 7, 2010, APF's broker-dealer began liquidating the fund's remaining holdings to satisfy outstanding margin demands. Days later, on May 13, the broker-dealer shut down APF's account and wired the fund's last $143,897 to an empty APF bank account controlled by Montanino's partner. Montanino's partner used approximately $24,000 of APF's last dollars to satisfy existing debt owed to lawyers and other service providers, and transferred $90,000 to a new online trading account opened in APF's name at another broker-dealer to be managed by an unrelated individual who lost the money on poor trades in two weeks.

22. Meanwhile, Montanino's client did not learn any substantive information about her investment until she obtained a second statement from the fund's administrator, dated May 19, 2010. The May 19 statement was outdated and incomplete, reflecting a mere 15.27 percent decrease in value as of March 31, 2010. In reality, records from APF's broker-dealer show that, by March 31, APF had leveraged nearly twice the amount of investors' deposits – comprised at the time of just two investments totaling about $484,000 – and had hundreds of thousands of dollars in pending, losing trades.

23. After reviewing the May 19 statement, Montanino's client contacted Montanino, who for the first time claimed his "boss" was wholly responsible for her losses. On his client's insistence, Montanino and his partner agreed to discuss her concerns in person at APE's offices on May 26, 2010.

24. Neither Montanino nor his partner disclosed to Montanino's client during the May 26 meeting the nature and extent of her investment losses. In fact, they were unwilling to provide any details of the trades that led to her losses, prompting her to request redemption of the remainder of her account as reflected on the May 19 statement (about $228,013). Even though APF did not have sufficient assets, Montanino and his partner promised to redeem her investment when the quarter ended, on June 30, 2010, creating the false impression that APF had sufficient assets to do so. Montanino even promised to return a 10 percent fee, or $29,900, APF charged to his client's subscription contrary to Montanino's representation to her that APF would not charge her principal.

25. Montanino continued the charade for over a month, emailing his client a redemption request form on June 30, 2010 and instructing her to submit the request through a New York City fax number, which she did. Montanino and his partner failed to redeem any part of her investment.

26. During a phone call in mid-July 2010, Montanino finally admitted to his client that her money was "all gone." But Montanino shirked responsibility, falsely claiming that that her losses occurred after his partner unilaterally transferred her investment to an unrelated hedge fund.

27. Montanino also advised his client during the July 2010 phone call to seek a "Ponzi-like" payment from his partner, suggesting that his partner, lacking sufficient funds or assets, could repay her from later investors' funds. Montanino's advice prompted his client to obtain legal counsel, who sent Montanino and his partner a letter, dated July 21, 2010, demanding a full accounting. Montanino's client repeated the demand in a text message to Montanino on July 29, 2010, but never obtained an accounting of her losses.

E. MONTANINO'S APE-RELATED MISCONDUCT

28. From July 2010 through April 2011, Montanino and his partner raised at least $485,000 from five APE investors with the understanding that, unlike funds that traded liquid securities on a public exchange, APE would pool the investors' money to make a private investment in Calibourne. Montanino and his business partner developed APE's investment strategy together and used that strategy to solicit investors through oral pitches and a written investor presentation Montanino prepared. But APE invested only a nominal amount of money in Calibourne, made no other investments during this period, and teetered at all times on the verge of collapse due to misappropriation.

Use of Unsubstantiated Hypothetical Valuation Models

29. The APE presentation Montanino prepared provided a hypothetical valuation model having no rational relationship to APE's past investment results or the purported present investment strategy. Specifically, the presentation represented that APE expected to manage $300-400 million in assets through Calibourne within *one* year, and sell Calibourne within three years, yielding a "7-10x Return on Capital Raise Investment."

30. But Montanino knew or recklessly disregarded facts indicating that APE's past investment operations did not support a reasonable comparison to this model. *First*, Montanino knew that APE existed as a supposed private equity fund of funds for over five years because, as explained, he helped form APE in 2005 and even solicited one of its first investors. Despite its longevity as a fund, APE had no active portfolio investments when Montanino became a senior managing director in late 2009, indicating, at best, APE's investment model was unsuccessful for four years. *Second*, Montanino was personally involved in managing APE's most recent investment failure, APF, which collapsed in about two months.

31. Montanino also knew when he prepared the presentation that APE's latest investment plan – financing Calibourne's operations and recruiting effort – did not support the hypothetical valuation model because neither Calibourne (and APE) nor Montanino had experience recruiting or supervising investment professionals or successfully managing money.

32. Moreover, APE, as Montanino knew, was in a precarious financial condition, calling into question whether investor money would be used as represented. Indeed, Montanino repeatedly told one graphic designer he hired to design several APE marketing documents that APE could not pay her invoices and depended on raising new money to sustain operations. Montanino also told a consultant hired to proof APE marketing documents to cash a check from APE right away, warning that money was "tight."

33. In late September 2010, Montanino's partner wrote him through personal email accounts about APE's desperate financial condition and the APE investor presentation Montanino was preparing:

> I will cover short term problems. I have a lot of investors counting on me. The resource section looks great and the additions you are putting together for Advisors and articles will really help out. Perhaps we can approach all current investors, show them the progress.... But we all have to CLOSE .... I have a great call scheduled for tomorrow.

Deceptive Conduct Concerning APE's Investment Strategy

34. In the APE investor presentation he prepared, Montanino described the investment strategy he and Sullivan devised: APE would invest the fund's assets in Calibourne, financing Calibourne's operations and efforts to persuade experienced financial professionals managing multi-millions of dollars to move those assets to Calibourne. Of the $485,000 raised from APE investors between July 2010 and April 2011, bank records show APE provided just $33,515 to Calibourne, most of which Montanino – who controlled Calibourne's only bank account – diverted for personal benefit.

35. Montanino also personally misled investors about APE's investment model while participating in "pitch" calls with his partner. During the summer and fall of 2010, for instance, Montanino told an existing APE investor ("APE Investor A") about the APE/Calibourne revenue model, stating over the phone that Calibourne would use the financing APE provided to recruit established financial professionals willing to transfer their clients' assets to Calibourne. APE Investor A invested an additional $100,000 in APE on March 23, 2011. But bank records show a transfer from APE to Calibourne of only $11,000 of APE Investor A's March 2011 investment, about half of which Montanino promptly transferred to his personal bank account while spending the rest on purposes unrelated to Calibourne.

36. Similarly, during a phone call in May or June 2010, Montanino described to another investor ("APE Investor B") the method through which he and his business partner would manage the investor's money – by funding the Calibourne recruiting effort, which ultimately would generate investment returns. APE Investor B invested $100,000 in APE in August 2010 and $25,000 in October 2010. Bank records for Calibourne and APE show APE did not fund Calibourne as represented. Instead, Montanino's partner used most of APE Investor B's money for personal benefit within weeks of obtaining it. APE's bank records even reflect the use of $10,000 of APE Investor B's August 2010 investment to make a Ponzi like payment to another investor.

37. After his partner's death through at least June 2011, concerned investors contacted Montanino about the status of their APE investments. Instead of telling them the truth, Montanino told them APE legitimately provided financing to Calibourne even though, as Calibourne's bank records show, it did not provide enough funding to execute the proposed business plan.

38. In an email on May 10, 2011, for instance, Montanino assured one APE victim, ("APE Investor C"), that "there was no 'scam' with [APE's] dealings with my company," stating:

> I believed at the time [] of investment, [APE] was getting a very good deal for the amount of capital that was allocated. Again, I don't know if [APE's] investments outside of what the firm did with Calibourne Capital Management were good or bad one's [sic], but I can tell you that [APE] did make a private investment in my company and for that investment, [APE] took a 50% ownership stake in Calibourne.

39. But APE did not allocate meaningful capital to Calibourne and Montanino used the nominal amount that APE provided to Calibourne for his personal benefit rather than for attracting investment professionals. Montanino therefore knew that APE used investors' money contrary to its disclosed investment strategy of financing Calibourne.

False and Misleading Statements About Montanino's Background

40. In the APE investor presentation he prepared, Montanino falsely represented that he had over 15 years of investment management experience for high-net worth clients and earned prestigious awards for his work. Montanino asserted, for instance, that he provided "investment management services for a client base with over $1 Billion in assets under management" during his tenure at a brokerage firm between 2005 and 2008, and earned that firm's "prestigious Chairman's Circle of Excellence Award." But the brokerage firm stated that Montanino never managed client assets and that no such award exists at the firm. In reality, Montanino's then-recent abysmal performance managing APF Investor A's money constituted his only actual investment management experience.

Looting of APE's Assets

41. Between at least July 2010 and April 2011, Montanino played an integral role in using APE as a vehicle for the misappropriations of his partner and, through Calibourne, himself.

42. During this time, investors sent about $485,000 by wire or check to APE's escrow account. Calibourne's bank records show that APE provided only about $33,515, of which Montanino took $28,870 for himself even though APE compensated Montanino tens of thousands of dollars directly from its own account. Montanino's partner looted the rest of APE's assets for personal benefit, transferring tens of thousands of dollars to his checking account, withdrawing substantial amounts in cash, paying others having no apparent business relationship with APE, and otherwise spending investors' money on luxury rental homes costing $15,500 to $20,000 per month, luxury car payments, shopping sprees, and to make partial redemption payments to existing investors. No investor funds remain.

43. Montanino knew of his own misappropriations and recklessly disregarded facts indicating his partner used APE's assets contrary to of the firm's disclosures to investors. As explained above, Montanino prepared APE's primary marketing document representing that

the fund would capitalize Calibourne. Montanino, who controlled Calibourne's only bank account, knew that no real capitalization materialized and, thus, knew his partner used investor money contrary to the representations both he and his partner made to fund investors.

VIOLATIONS

44. As a result of the conduct described above, Respondent willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the offer or sale of securities and the purchase or sale of securities.

45. As a result of the conduct described above, Respondent willfully violated Sections 206(1) and (2) of the Advisers Act, which prohibit an investment adviser from employing any device, scheme, or artifice to defraud, or engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon, any client or prospective client.

46. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which prohibit any fraudulent, deceptive, or manipulative act, practice, or course of business by an investment adviser to any investor or prospective investor in a pooled investment vehicle.

47. As a result of the conduct described above, Montanino willfully aided and abetted, and caused APE's primary violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the offer or sale of securities and the purchase or sale of securities.

48. As a result of the conduct described above, Montanino willfully aided and abetted, and caused APE's primary violations of Sections 206(1) and (2) of the Advisers Act, which prohibit an investment adviser from engaging in any act, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act; and

C. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Respondent should be ordered to cease and desist from

committing or causing violations of, and any future violations of, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), (2), and (4) of the Advisers Act and Rule 206(4)-8 thereunder, whether Respondent 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 203(i) of the Advisers Act, and whether Respondent 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 203(j) 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 not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

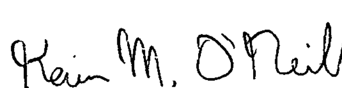
If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.



Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72460)

June 24, 2014

Order Directing the Exchanges and the Financial Industry Regulatory Authority To Submit a Tick Size Pilot Plan

Notice is hereby given that, pursuant to Section 11A(a)(3)(B) of Securities Exchange Act of 1934 ("Act"),[1] the Securities and Exchange Commission ("Commission") orders the BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., The Nasdaq Stock Market LLC, Nasdaq OMX BX, Nasdaq OMX Phlx, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE Arca, Inc., NYSE MKT LLC, and Financial Industry Regulatory Authority, Inc. ("FINRA") (collectively the "Participants" and individually a "Participant") to act jointly in developing and filing with the Commission a national market system plan to implement a pilot program that, among other things, would widen the quoting and trading increments for certain small capitalization stocks as described in detail below ("Tick Size Pilot Plan"). The Tick Size Pilot Plan should be filed with the Commission pursuant to Rule 608 under the Act[2] no later than [60] days after issuance of this Order.

I. Background

Prior to implementing decimal pricing in April 2001, the U.S. equity markets used fractions as minimum pricing increments. In the 1990s, the Commission began to re-examine

1 Section 11A(a)(3)(B) authorizes the Commission, in furtherance of its statutory directive to facilitate the establishment of a national market system, by rule or order, "to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under [the Act] in planning, developing, operating, or regulating a national market system (or a subsystem thereof) or one or more facilities thereof." 15 U.S.C. 78k-1(a)(3)(B).

2 17 CFR 242.608.

the fractional pricing structure, and in 1994, the Commission staff issued a report (the "Market 2000 Report") on the equities markets that, among other things, expressed concern that the then-existing 1/8th of a dollar minimum pricing increment was "caus[ing] artificially wide spreads and hinder[ing] quote competition," leading to excessive profits for market makers.[3] In the Market 2000 Report, the Commission staff also expressed concern that fractional pricing put the U.S. equity markets at a competitive disadvantage to foreign equity markets that used decimal pricing increments. The Commission used these findings as part of a public discussion on whether the U.S. equity markets should adopt a lower fractional minimum tick size or adopt decimal pricing.

At the same time, the exchanges and NASDAQ (the predecessor to The Nasdaq Stock Market LLC) began to implement lower tick sizes, generally to 1/16th of $1.00.[4] The Commission, the exchanges and NASDAQ believed that the reductions in tick size would provide multiple benefits to the equity markets, including better pricing and greater liquidity.

In January 2000, the Commission ordered the exchanges and NASD (the predecessor to FINRA) to submit a decimalization plan that would implement decimal pricing in certain

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3 See Securities and Exchange Commission, Market 2000: An Examination of Current Equity Market Developments (1994).

4 See Securities Exchange Act Release Nos. 31118 (August 28, 1992), 57 FR 40484 (September 3, 1992) (SR-Amex-91-07) (Order approving proposed rule change relating to amendments to rule 127-minimum fractional changes); 38571 (May 5, 1997), 62 FR 25682 (May 9, 1997) (SR-Amex-97-14) (Order granting approval to proposed rule change relating to trading in 1/16th of $1.00); 38897 (August 1, 1997), 62 FR 42847 (August 8, 1997) (SR-NYSE-97-21) (Order granting approval to proposed rule change relating to trading differentials for equity securities); 38678 (May 27, 1997) 62 FR 30363 (June 3, 1997) (SR-NASD-97-27) (Order granting approval to proposed rule change to decrease the minimum quotation increment for certain securities listed and traded on The NASDAQ Stock Market to 1/16th of $1.00). These tick sizes were not binding on other markets. Some electronic communication networks (ECNs) allowed prices in increments of 1/256th of $1.00. See also Securities Exchange Act Release No. 44568, 66 FR 38390, 38392 (July 24, 2001) (Request for Comment on the Effects of Decimal Trading in Subpennies).

securities by July 2000.[5] Throughout 2000, the Commission and the self-regulatory organizations ("SROs") worked to phase-out fractional pricing and phase-in decimal pricing.[6] The conversion to decimal pricing was completed in April 2001.[7] These actions reduced the allowable tick size to a penny but did not mandate a minimum tick size.

In 2004, the Commission proposed, and then re-proposed, Rule 612 of Regulation NMS to establish a minimum price variation ("MPV") of one penny.[8] Several commenters on the original proposal had recommended an MPV of greater than one penny. In response, the Commission noted that proposed Rule 612 would "set a floor for the MPV, not determine an optimal MPV."[9] The Commission further stated that the conversion to decimal pricing had "reduced spreads, thus resulting in reduced trading costs for investors entering orders – particularly for smaller orders – that are executed at or within the quotations,"[10] and because of these benefits the Commission did not propose a higher MPV. It added, however, that "if the SROs in the future believe that an increase in the MPV is necessary or desirable, they may

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5 See Securities Exchange Act Release No. 42360 (January 28, 2000), 65 FR 5003 (February 2, 2000) ("January Order").

6 In April 2000, the Commission issued an order staying the deadlines set forth in the January Order and issued a notice requesting comment on two alternatives for implementing decimalization. See Securities Exchange Act Release No. 42685 (April 13, 2000), 65 FR 21046 (April 19, 2000). In June, the Commission issued another order that directed the exchanges and NASD to submit a plan to phase-in decimal pricing starting in in September 2000, which was to be completed by April 2001. See Securities Exchange Act Release No. 42914 (June 8, 2000), 65 FR 38010 (June 19, 2000).

7 The exchanges and NASD submitted a plan, started the phase-in on time and finished implementing decimalization by April 2001. See Commission Notice: Decimals Implementation Plan for the Equities and Options Markets (July 24, 2000), available at http://www.sec.gov/rules/other/decimalp.htm.

8 See Securities Exchange Act Release No. 50870 (December 16, 2004), 69 FR 77424 (December 27, 2004) (Regulation NMS proposing release).

9 Id. at 77458.

10 Id.

propose rule changes to institute the higher MPV"[11] and that the Commission would evaluate them at that time. In 2005, the Commission adopted Regulation NMS Rule 612, and since that time the one penny MPV has applied to all listed stocks priced at $1.00 or more per share.[12]

Since the adoption of Regulation NMS, the Commission has continued to evaluate tick sizes in the equity markets.[13] In January 2010, the Commission issued a Concept Release, which requested comments on issues, including high frequency trading, order routing, market data linkages, and undisplayed liquidity.[14] In the discussion on undisplayed liquidity, the Commission requested comments on whether public price discovery and execution quality have suffered, and specifically questioned whether the minimum pricing increment for lower priced stocks should be reduced, noting that broker-dealers may have greater incentives to internalize low-priced stocks than higher priced stocks, given the relatively larger minimum spreads that could be earned by broker-dealers. In response, the Commission received several letters

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11 Id.

12 Rule 612 specifies minimum pricing increments for NMS stocks. In general, Rule 612 prohibits market participants from displaying, ranking, or accepting quotations, orders, or indications of interest in any NMS stock priced in an increment smaller than $0.01 if the quotation, order, or indication of interest is priced equal to or greater than $1.00 per share. If the quotation, order, or indication of interest is priced less than $1.00 per share, the minimum pricing increment is $0.0001. 17 CFR 242.612. An NMS stock means any security or class of securities, other than an option, for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan. See 17 CFR 242.600(b)(46) and (47).

13 In addition, the Commission has evaluated tick sizes in the options market and has approved a penny pilot program in the options markets. See e.g., Securities and Exchange Act Release Nos. 55153 (January 23, 2007), 72 FR 4553 (January 31, 2007) (SR-Phlx-2006-74); 55154 (January 23, 2007), 72 FR 4743 (February 1, 2007) (SR-CBOE-2006-92); 55155 (January 23, 2007), 72 FR 4741 (February 1, 2007) (SR-BSE-2006-49); 55156 (January 23, 2007), 72 FR 4759 (February 1, 2007) (SR-NYSEArca-2006-73); 55161 (January 24, 2007), 72 FR 4754 (February 1, 2007) (SR-ISE-2006-62); and 55162 (January 24, 2007), 72 FR 4738 (February 1, 2007) (SR-Amex-2006-106).

14 See Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594 (January 21, 2010) ("Concept Release").

opposing[15] and supporting[16] a pilot program to test sub-penny tick increments. The Commission also received letters recommending a pilot program to test a wider variety of tick sizes.[17]

From time to time since the introduction of decimal pricing, concerns have been raised that the one penny MPV may be detrimental to small- and middle-sized companies. In

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15 See, e.g., Letters from Karrie McMillan, General Counsel, Investment Company Institute, dated April 21, 2010; Ann Vlcek, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated April 29, 2010; James J. Angel, Associate Professor, McDonough School of Business, Georgetown University; Lawrence E. Harris, Fred V. Keenan Chair in Finance, Professor of Finance and Business Economics, Marshall School of Business, University of Southern California; Chester S. Spatt, Pamela R. and Kenneth B. Dunn Professor of Finance, Director, Center for Financial Markets, Tepper School of Business, Carnegie Mellon University, dated February 23, 2010.

16 See, e.g., Letters from Eric Swanson, General Counsel, BATS Exchange, Inc., dated April 21, 2010 and Eric W. Hess, General Counsel, Direct Edge, dated April 28, 2010.

17 See, e.g., Letters from Janet M. Kissane, SVP – Legal and Corporate Secretary, Office of the General Counsel, NYSE Euronext, dated April 23, 2010; and John A. McCarthy, General Counsel, GETCO LLC, Christopher R. Concannon, Partner, Virtu Financial LLC, and Leonard J. Amoruso, General Counsel, Knight Capital Group, Inc., dated July 9, 2010. In addition, in April 2010, BATS Exchange, Inc., NASDAQ OMX Group, Inc., and NYSE Euronext, Inc. petitioned the Commission to exercise its exemptive authority under Rule 612(c) of Regulation NMS to implement a pilot program that would permit market participants to display, rank, or accept from any person, a bid or offer or order in a tick increment smaller than $0.01. See Letter from Chris Isaacson, Chief Operating Officer, BATS Exchange, Inc., Eric Noll, Executive Vice President, NASDAQ OMX Group, Inc., and Larry Leibowitz, Chief Operating Officer, NYSE Euronext, Inc. to Elizabeth M. Murphy, Secretary, Commission, dated on April 30, 2010 ("BATS/NASDAQ/NYSE Letter") and available at http://www.sec.gov/spotlight/regnms/jointnmsexemptionrequest043010.pdf. The petitioners stated their belief that the $0.01 MPV has resulted in artificially wide publicly-displayed quotes for certain lower-priced, liquid securities, which has negatively impacted the public price discovery process and resulted in inferior execution prices for investors. The petitioners requested the Commission to implement a six-month pilot program to permit sub-penny quoting at $0.005 in certain securities trading between $1.00 and $20.00 (the securities are listed on the Appendix to the petitioners' letter and included an exchange-traded fund (QQQQ), which trades at a price greater than $20.00). The petitioners stated their belief that allowing a smaller MPV for certain lower-priced, but liquid, securities would allow competitive market forces to better reflect an approximation of a stock's value.

particular, a few studies have raised questions regarding whether decimalization has reduced incentives for underwriters to pursue public offerings of smaller companies, limited the production of sell-side research for small and middle capitalization companies, and made it less attractive to become a market maker in the shares of smaller companies.[18]

In 2012, Congress passed the Jumpstart Our Business Startups Act ("JOBS Act"), which contained provisions relating to the impact of decimalization on small and middle capitalization companies. Specifically, Section 106(b) of the JOBS Act directed the Commission to conduct a study and report to Congress on how decimalization affected the number of initial public offerings ("IPOs"), and the liquidity and trading of smaller capitalization company securities. The Commission submitted the staff study to Congress in the July 2012 Decimalization Report.[19]

The Decimalization Report summarized the academic literature relating to the impact of decimalization on the market generally, and on the securities of small and middle capitalization companies. The Commission staff noted that there were no academic papers that directly examined the relationship between decimalization and the number of IPOs. The academic studies summarized in the Decimalization Report analyzed decimalization's impact on spreads, depth, execution speed, trade size, specialist/market maker participation and profitability, market and limit orders, order routing, volatility, and incentives for broker promotion. The Decimalization Report identified the main empirical findings of the academic literature in each of these areas. For example, some studies found that while both effective and quoted spreads declined after decimalization, there is some evidence that, at least for NASDAQ small

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18 For a complete discussion of these studies see *Report to Congress on Decimalization* (July 2012) available at http://www.sec.gov/news/studies/2012/decimalization-072012.pdf ("Decimalization Report").

19 See id.

capitalization stocks, the decline is not statistically significant, and the effect of decimalization on institutional transaction costs is mixed. In addition, some studies found that while quoted depth, on average, declined after decimalization, cumulative depth at competitive prices did not change. Some studies found that market maker participation increased after decimalization across all market capitalization categories, but decimalization does not appear to have reduced profitability.

In the Decimalization Report, the Commission staff also surveyed tick-size conventions in non-U.S. markets. Many foreign jurisdictions utilize a tiered tick size approach that provides greater variability for tick sizes based on the price level of a stock rather than the "one size fits all" approach utilized in the United States. Many countries have tick sizes that are four or more times wider than in the U.S. on a percentage basis. However, a few other countries have tick sizes that are less than half the size of the U.S. on a percentage basis. Therefore, the Decimalization Report stated that the U.S. market would benefit from a broad review of tick sizes, and such review would be informed by the experiences in other countries.[20]

Finally, the Decimalization Report considered the panel discussion that occurred during the meeting of the SEC Advisory Committee on Small and Emerging Companies ("Small Company Advisory Committee")[21] in June 2012 that related to market structure issues and their impact on small and middle capitalization companies and on IPOs. In particular, some Small

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[20] See Decimalization Report at 18. The Decimalization Report also examined the level of small company IPOs in other countries during the time before and after decimalization to assess whether other countries had experienced declines in small company IPOs like the U.S. experienced. An examination of other countries' IPO activities did not show a decline like that experienced in the U.S., even in those countries that have smaller tick sizes.

[21] More information on the committee is available at http://www.sec.gov/info/smallbus/acsec.shtml.

Company Advisory Committee members commented that it may be hard to isolate the impact of decimalization on small company IPOs from other concurrent factors, such as the enactment of the Sarbanes-Oxley Act in 2002, the Global Analyst Research Settlement in 2003, and the emergence of high frequency trading and dark pools. As discussed further below, the Small Company Advisory Committee continued to evaluate the issues raised by decimalization and its impact on small capitalization companies, and issued recommendations in February 2013.[22]

While the Decimalization Report did not reach any firm conclusions about the impact of decimalization on the number of IPOs or the liquidity and trading of small capitalization companies, it did recommend that the Commission continue to study this area. The Decimalization Report specifically suggested a public roundtable, where recommendations could be presented on a pilot program that would generate data to allow the Commission to further assess decimalization's impact. On February 5, 2013, the Commission staff held a Decimalization Roundtable with participation from a wide range of market participants, academics, and others. Many of the panelists were of the view that factors other than decimalization were more significant factors in the decline in IPOs in recent years. While views differed on the likely outcome of any increase in the minimum tick size, there was broad support among the panelists for the Commission to conduct a pilot program to gather further information, particularly with respect to the impact of wider tick sizes on liquidity in small capitalization companies.[23] This view was reflected in comment letters submitted to the Commission in

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[22] See note 26 infra.

[23] There was some discussion at the Roundtable about the BATS/NASDAQ/NYSE Letter, which requested the implementation of a sub-penny pilot, see supra note 17. See also letter from Chris Isaacson, SVP & COO and Eric Swanson, Secretary, BATS Global Markets to Elizabeth M. Murphy, Secretary, Commission, dated January 29, 2013). In general, some panelists suggested that adding narrower ticks to a pilot could

advance of the Roundtable.[24] Some panelists, however, expressed concern about the potential costs to investors of wider minimum tick sizes.[25]

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counterbalance the negative issues related to the potentially increased costs to investors for the widening of spreads in small stocks. However, panelists noted that institutional investors and issuers were not supportive of narrower tick sizes and one panelist suggested that any pilot should be limited to the small cap issuers to keep it simple and targeted for the market.

24 See e.g. letters from Chris Isaacson, SVP & COO, and Eric Swanson, Secretary, BATS Global Markets, Inc., dated January 29, 2013 (suggesting a tick size pilot could be used to determine the optimal tick size for enabling efficient price discovery, while maintaining low transaction costs for investors, and improving efficient access to capital for small and middle capitalization companies), David Weild, Senior Advisor, Grant Thornton LLP, dated January 29, 2013 (indicating the belief that the implementation of a tick size pilot could be a step in increasing the number of initial public offering), Paul Jiganti, Managing Director, Market Structure Client Advocacy, TD Ameritrade, Inc., dated February 4, 2013 (indicating support for a tick size pilot and suggesting that such a pilot should focus on trading volume, price, volatility, and to a lesser extent, market capitalization), Patrick J. Healy, CEO, Issuer Advisory Group, dated February 4, 2013 (indicating the belief that while decimalization has been beneficial to the market, they would support a tick size pilot that would focus on less liquid companies), Colin Clark, Senior Vice President, NYSE Euronext, dated February 5, 2013 (suggesting that less liquid companies could benefit from increased tick sizes and that a pilot program could provide the Commission with data that can be utilized in a cost-benefit analysis to determine whether or not to make the pilot permanent), and Jeffrey M. Solomon, Chief Executive Officer, Cowen and Company, dated February 5, 2013 (suggesting that a pilot program could provide economically feasible means for investment banks to provide research on small capitalization stocks).

25 A transcript of the Decimalization Roundtable is available at http://www.sec.gov/news/otherwebcasts/2013/decimalization-transcript-020513.txt. In addition, comments received by the Commission are available at http://www.sec.gov/comments/4-657/4-657.shtml. Since the roundtable, the Commission has received eleven additional comment letters. Generally, these later commenters expressed support for a pilot program to test wider tick size for smaller capitalization companies. See, e.g., letters from David Weisberger, Executive Principal, Two Sigma Securities, dated April 23, 2013; Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, Managed Funds Association, dated May 1, 2013; Ernest F. Callipari, Equity Trader, dated May 29, 2013; Daniel Keegan, Managing Director, Head of Equities for the Americas, Citigroup Global Markets Inc., dated October 22, 2013 (commenting that pilot program should apply to illiquid stocks of all sizes); and Joseph Saluzzi, Partner, Themis Trading LLC, dated November 20, 2013. One commenter suggested that the Commission set the MPV at five cents. See letter from James J. Maguire, Sr., to Chair White, dated January 21, 2014.

Since the Decimalization Roundtable, discussions have continued with respect to the possibility of raising the minimum tick sizes for small capitalization stocks, and the prospect of a pilot program to test the impact thereof. The Small Company Advisory Committee, in March 2013, recommended that the Commission adopt rules that would allow small exchange-listed companies to choose their own minimum tick size from a limited range designated by the Commission.[26] In the view of the Small Company Advisory Committee, the economic incentives provided by wider minimum tick sizes would encourage market making and research analyst coverage, and thereby enhance the attractiveness of the IPO market for small companies and their ability to raise capital.

In November 2013, the Equity Capital Formation Task Force ("ECFTF")[27] issued to the U.S. Department of the Treasury its report: *From the On-Ramp to the Freeway: Refueling Job Creation and Growth by Reconnecting Investors with Small-Cap Companies* ("ECFTF Report").[28] The ECFTF recommended, among other things, that the exchanges conduct a pilot program, overseen by the Commission, that would establish the Small-cap Trading Rules ("STaR") where, companies with a market capitalization below $750 million would be quoted in

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26 See Advisory Committee on Small and Emerging Companies, *Recommendations Regarding Trading Spreads for Smaller Exchange-Listed Companies* (February 1, 2013) available at http://www.sec.gov/info/smallbus/acsec/acsec-recommendation-032113-spread-tick-size.pdf

27 The Equity Capital Formation Task Force is comprised of representatives from mutual funds, venture capital firms, exchanges, broker-dealers, academics, investor relations advisors and securities industry trade groups. The task force was formed in June 2013 to: (1) examine the challenges that startups and small-cap companies face in raising equity capital in the public market environment, and (2) develop recommendations for policy-makers that will help such companies gain greater access to the capital they need to grow their businesses and generate private sector job growth.

28 This report is available at http://www.equitycapitalformationtaskforce.com/files/ECF%20From%20the%20On-Ramp%20to%20the%20Freeway%20vF.pdf.

$0.05 increments and would trade only at the bid, the offer, or the mid-point between the bid and the offer.

More recently, on January 31, 2014, the Commission's Investor Advisory Committee ("Investor Advisory Committee"),[29] recommended that the Commission not conduct a pilot program to study increased minimum tick sizes for small-capitalization companies.[30] In general, the Investor Advisory Committee expressed concern that a pilot that widens the minimum quoting increment would disproportionately harm retail investors because their trading costs would rise.[31] If the Commission determines to conduct a tick size pilot,[32] however, the Investor Advisory Committee recommended that any such pilot: (a) should be short-term, with a guaranteed sunset unless benefits are proven to outweigh the costs; (b) should be designed to

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29 The Investor Advisory Committee was established by Section 911 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), to advise the Commission on regulatory priorities, the regulation of securities products, trading strategies, fee structures, the effectiveness of disclosure, and on initiatives to protect investor interests and to promote investor confidence and the integrity of the securities marketplace. The Dodd-Frank Act authorizes the Investor Advisory Committee to submit findings and recommendations for review and consideration by the Commission. See Section 911 of the Dodd-Frank Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

30 The Investor Advisory Committee recommendations are available at http://www.sec.gov/spotlight/investor-advisory-committee-2012/decimal-pricing-draft-recommendation-iac.pdf. A member of the IAC dissented from this recommendation and recommended that the Commission conduct a pilot program with respect to modified decimal pricing. The dissenting opinion is available at http://www.sec.gov/spotlight/investor-advisory-committee-2012/dissenting-opinion-decimalization-iac.pdf.

31 The Investor Advisory Committee suggested that, if the Commission believes additional steps are needed to promote capital formation or enhance liquidity for smaller capitalization securities, the Commission should consider all approaches, such as, requiring the display of depth-of-book of orders, restricting certain jumping ahead strategies, and rules that better assure the validity of displayed quotes. See Investor Advisory Committee recommendations, supra note 30.

32 The Investor Advisory Committee noted that if the Commission nevertheless were to propose a pilot, it would review the details of the proposal and potentially reconsider its recommendation. See Investor Advisory Committee recommendations, supra note 30.

measure the costs and benefits to investors, with a particular focus on retail investors; and (c) should not focus exclusively on increasing tick size, but also on other changes that could encourage appropriate trading, enhance liquidity, or facilitate capital formation.[33]

II. Discussion

Section 11A(a)(2) of the Act[34] directs the Commission, having due regard for the public interest, the protection of investors, and the maintenance of fair and orderly markets, to facilitate the establishment of a national market system for securities. Section 11A(a)(3)(B) provides the Commission the authority to require the SROs, by order, "to act jointly ...in planning, developing, operating, or regulating a national market system (or a subsystem thereof)."[35]

The Commission believes that it is in the public interest for the Participants to develop and file with the Commission a Tick Size Pilot Plan, with the terms and conditions set forth in Section III below, as a national market system ("NMS") plan pursuant to Rule 608(a) of Regulation NMS.[36] Once filed, the Commission would publish the Tick Size Pilot Plan for public comment, and thereafter consider whether to approve it, in accordance with Rule 608(b) of Regulation NMS.[37]

Decimalization of the U.S. equity markets occurred over a decade ago. Since that time, the nature of trading, the structure of the markets, and the roles of market participants have

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33 The Commission continues to review the findings and recommendations of the Investor Advisory Committee. See Section 911(g) of the Dodd-Frank Act.

34 15 U.S.C. 78k-1(a)(2).

35 15 U.S.C. 78k-1(a)(3)B).

36 17 CFR 242.608(a).

37 17 CFR 242.608(b).

changed significantly.[38] As discussed above, concerns have been expressed from a variety of sources that decimalization, and the associated one penny MPV, may have had a detrimental impact on the trading and liquidity of small capitalization stocks.[39] Therefore, the Commission believes that it is in the public interest for the Commission to further study and assess decimalization's impact on the liquidity and trading of the securities of small capitalization companies.[40] The submission of proposed NMS plan for a Tick Size Pilot Plan will provide the Commission with the means to continue to gather further information and views on the impact of decimalization on the liquidity and trading of the securities of small capitalization companies. In addition, a proposed NMS plan for a Tick Size Pilot Plan would allow the Commission to gather further comments on whether a Tick Size Pilot Plan is a viable vehicle by which the Commission could gather data to test whether a wider tick benefits small capitalization companies and their investors.

In the Decimalization Report, the Commission staff reviewed academic literature related to the impact of decimalization on the U.S. equity markets. While the academic literature indicated a number of potential benefits from decimalization, such as an overall reduction in effective and quoted spreads, there was some evidence that, at least for NASDAQ small

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38 See e.g., Concept Release, supra note 14.

39 See e.g., *Rebuilding the IPO On-Ramp*, presented to the U.S. Department of Treasury (2011)("IPO Task Force Report"); David Weild and Edward Kim, *Market Structure is Causing the IPO Crisis – and More*, Grant Thornton Capital Markets Series (June 2010).

40 The Commission notes that some market participants have recommended that the Commission implement a pilot program that would permit tick increments smaller than $0.01. See BATS/NASDAQ/NYSE Letter, supra note 17. The Commission continues to evaluate this petition. At this time, however, the Commission preliminarily believes that the Tick Size Pilot Plan should focus on the impact of wider ticks on the trading and liquidity of smaller companies for the reasons discussed herein.

capitalization stocks, the decline was not statistically significant.[41] The academic literature also found, post-decimalization, evidence of a decline in quoted depth on average (although cumulative depth at competitive prices did not appear to change), smaller trade sizes, and an increase in the total time to work institutional orders.[42] In addition, the Decimalization Report noted that the U.S. has an essentially flat, "one size fits all" tick size regime, as compared with many foreign jurisdictions that have adopted tiered regimes where the tick size varies depending on the price level of a stock.[43] Finally, at the Decimalization Roundtable, there was broad support among the panelists for the Commission to conduct a pilot program with respect to the impact of wider tick sizes on liquidity in small capitalization companies, even though views differed on the likely outcome of the pilot.[44]

Support for a pilot program is not universal, however, particularly given that an increase in minimum tick sizes may raise costs for investors. This view was reflected, for example, at the Roundtable and in the recommendations of the Investor Advisory Committee.[45]

Nevertheless, the Commission believes that legitimate questions have been raised as to whether the minimum tick size regime for the U.S. equity markets should be refined and enhanced. Specifically, the Commission preliminarily believes that it should assess, through a targeted short-term pilot program, whether wider minimum tick sizes for small capitalization stocks would enhance market quality to the benefit of market participants, issuers and U.S. investors. The Commission preliminarily believes that such a pilot should facilitate studies of

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41 See Decimalization Report.

42 See id.

43 See id.

44 See supra note 25 and accompanying text.

45 See supra notes 29 to 33 and accompanying text.

the effect of tick size on liquidity, execution quality for investors, volatility, market maker profitability, competition, transparency and institutional ownership. The Commission has set forth the details of a pilot program that the Commission preliminarily believes would produce measurable data that would allow the Commission and others to conduct such studies.

Further, the Commission preliminarily believes that the pilot described below is sufficiently limited so as to not cause excessive disruption to the market. The Commission preliminarily believes that the terms of the Tick Size Pilot Plan and the securities to be included should mitigate potential harm to investors in the form of increasing transaction costs, as expressed by the Investor Advisory Committee. The Commission would examine the data generated to measure, among other things, any change in transaction costs.

The Commission is ordering the Participants to jointly file the Tick Size Pilot Plan to assure that the pilot program, if ultimately approved by the Commission, applies uniformly across the U.S. markets. Once the Participants file the Tick Size Pilot Plan with the Commission, it will be published for public comment, and the Commission will carefully evaluate the comments received as the Commission considers whether to approve the Tick Size Pilot Plan.[46]

III. Tick Size Pilot Plan

The Commission hereby orders the Participants to develop and jointly file with the Commission, as an NMS plan pursuant to Rule 608(a) of Regulation NMS,[47] a Tick Size Pilot Plan with the following terms and conditions:

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[46] 17 CFR 242.608(b).

[47] 17 CFR 242.608(a).

- **Duration.** The length of the pilot program ("Pilot") contemplated by the Tick Size Pilot Plan shall be one year. The Commission notes that there has been broad discussion about how long a pilot should run.[48] The Commission preliminarily believes that a one-year time period would generate sufficient data to reliably analyze the effects and impact of wider tick size.[49] The Commission preliminarily believes that the Participants should monitor the data generated during the Pilot Period.[50] The Commission expects that the data produced during the Pilot Period should allow the Commission and Participants to monitor the impact of the Pilot on the market and investors. Further, the Commission would engage in a proactive, ongoing review of the data that could inform whether any modifications of the Pilot are necessary.

- **Securities.** The securities to be included in the Pilot shall be securities that are NMS common stocks with: (1) a market capitalization of $5 billion or less; (2) an average daily trading volume of one million shares or less; and (3) a share price of $2 per share or more ("Pilot Securities"). The Commission preliminarily believes that these criteria will capture the securities of smaller and middle capitalization companies with low liquidity and trading activity and should

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48 See e.g., Letters from Jeffrey M. Solomon, Chief Executive Officer, Cowen and Company, dated February 5, 2013 (suggesting a pilot term of 7 years); David Weild, Senior Advisor, Grant Thornton LLP, dated January 29, 2013 (suggesting a pilot term of 5 years); Colin Clark, Senior Vice President, NYSE Euronext, dated February 5, 2013 (suggesting a pilot term of no longer than one year); David Weisberger, Executive Principal, Two Sigma Securities, dated April 23, 2013 (suggesting a pilot term of at least one year); and Daniel Keegan, Managing Director, Head of Equities for the Americas, Citigroup Global Markets, Inc., dated October 22, 2013 (suggesting a pilot term of one year). See also, the Investor Advisory Committee recommendations, supra note 30, which recommended that any pilot be short-term, with a guaranteed sunset.

49 These preliminary beliefs are based on analysis of power statistics for relevant liquidity measure, e.g., trading volume. Being able to examine a subset of stocks facilitates the examination of potential threshold levels.

50 During the Pilot Period, the Commission preliminarily believes that Participants should notify the Commission if they detect any broadly negative impact of the Pilot on market quality.

provide the Pilot with a broad sample on which to test the impact of wider tick sizes.[51] Requiring stock prices to be $2 or more per share assures that "sub-penny stocks"[52] are not included in the Pilot.

In addition, these thresholds are not set directly by the tick size so they are relatively exogenous, which could help to inform the Commission about any potential rulemaking based on the results of the Pilot. Overall, because the stocks below these thresholds have higher average effective spreads, the thresholds, though exogenous help to target the pilot towards those stocks most likely to benefit from a larger tick size. Finally, this group is broad enough to allow researchers to examine various threshold levels for potential rulemaking.

- **Pilot Design.** The Pilot should consist of one control group and three test groups with 300 Pilot Securities in each test group. The selection of Pilot Securities to be included in each test group should involve stratified sampling by market capitalization and price. The Commission preliminarily believes that choosing three relatively small test groups would minimize any potential disruption to the current market.[53] The Commission also preliminarily

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51 The market capitalization and average daily trading volume thresholds are based on a staff examination of effective spreads. Stocks above these thresholds typically have effective spreads below $0.02. Stocks below these thresholds vary with some in the $0.01 range but most above $0.02 and a substantial percentage above $0.05. These thresholds should capture the stocks that would benefit most from an increased tick size while still allowing researchers to assess which stock characteristics might be correlated with positive results from larger tick sizes and which would be correlated with negative results from larger tick sizes.

52 "Sub-penny stocks" are NMS stocks with a stock price below $1 that have a minimum quote increment of $0.0001 under current rules. The threshold of $2 was chosen to mitigate the effect of NMS stocks for which stock prices may decline to below $1 during the pilot period.

53 Some commenters suggested that a pilot test several tick sizes. See e.g., Letter from David Weild, Senior Advisor, Grant Thornton LLP, dated January 29, 2013 (suggesting five tick increments of $0.25, $0.10, $0.05, $0.02, and $0.01); and Jeffrey M. Solomon, Chief Executive Officer, Cowen and Company, dated February 5, 2013 (suggesting four

believes that having a control group is vital to test the effects of larger tick size, and that a control group with the current quoting and trading increments would best represent a baseline for the analysis of the effect of the pilot. Further, the Commission preliminarily believes that three test groups should generate sufficient data to test a variety of potential changes, described below. Finally, the Commission preliminarily believes that the inclusion of 300 Pilot Securities per test group should allow each test group to be statistically large enough to generate data to reliably test for the effects of larger tick size and to examine thresholds for any potential rulemaking in the future.[54]

- **Control Group.** Pilot Securities in the Control Group shall be quoted at the current tick size increment, $0.01 per share, and trade at the increments currently permitted.
- **Test Group One.** Pilot Securities in Test Group One would be quoted in $0.05 minimum increments. Trading could continue to occur at any price increment that is permitted today. The Commission preliminarily believes that the $0.05 minimum quoting increment is appropriate. Commission staff's preliminarily analysis of the Pilot Securities[55] indicates that a significant percentage of Pilot Securities have bid-ask spreads greater than $0.05. Therefore, the

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tick increments of $0.20, $0.10, $0.05 and $0.01). At this time, the Commission is concerned about the cost and complexity of a pilot that contains more test groups. See e.g., Letter from David Weisberger, Executive Vice President, Two Sigma Securities, dated April 23, 2013 to Elizabeth M. Murphy, Secretary, Commission ("We urge the Commission to keep the design of the pilot simple. Simplicity will ensure timely implementation and reduce operational risks as most firms will have to conduct an extensive review of their trading software to comply with the pilot.").

[54] These preliminary beliefs are based on staff analysis of power statistics for relevant liquidity measures, e.g., trading volume. In particular, the staff focused on the least active stocks and assessed how many stocks would be needed to detect changes in daily liquidity measures. The staff selected 300 as a sample size to provide sufficient power to detect changes in liquidity measures for a subset of pilot stocks.

[55] See supra note 51.

Commission believes that the five cent increment should be relatively conservative so as to limit increases in transaction costs for investors.[56] In addition, for those securities that currently have spreads greater than $0.05, the introduction of a minimum quoting increment would prevent market participants from "pennying" quotes, (i.e., improving the displayed quote by only one penny to gain execution priority) as quotes will be made in 5 cent increments. Finally, the 5 cent minimum quoting increment will allow data to be developed to test whether liquidity increases due to the aggregation of liquidity at the 5 cent increments for these securities.

There are other Pilot Securities that currently have spreads that are less than $0.05. The spreads in these Pilot Securities would be directly impacted. However, their inclusion in the Pilot would allow data to be developed to study the impact on liquidity for these stocks as well. Moreover, trading in this group can occur at any price increment allowable today, so the data generated from this group should isolate the effects of an increased quoting increment.

The $0.05 minimum quoting increment is significantly larger than the current $0.01 but smaller than the 1/16th of $1.00 increment used immediately prior to decimalization. Relative to the alternative minimum quoting increments that could be considered, the Commission preliminarily believes $0.05 provides a good balance between assuring the ability to measure the hypothesized effect, if it exists, and mitigating any potential harm to liquidity as a result of a tick size that is too large. Therefore, the Commission preliminarily believes that a $0.05 minimum quoting increment should be sufficient to test the effects of a larger minimum quoting increment for the Pilot Securities. The Commission preliminarily believes that changing the minimum

56 The transaction cost is measured by the difference of an investor buying a security at the offer and then immediately selling the same security at the bid. Thus, the wider the minimum quoting increment, the greater the transaction cost would be for such round trip trade.

quoting increment for Test Group One would generate data about the impact of changing the minimum quoting increment, and only the minimum quoting increment, for the Pilot Securities overall.

- **Test Group Two.** Pilot Securities in Test Group Two would be quoted in $0.05 minimum increments, and traded in $0.05 minimum increments subject to certain exceptions. The following exceptions from the $0.05 minimum trading increment would be permitted: (1) trading could occur at the mid-point between the national best bid or offer ("NBBO"); (2) retail investor orders could be provided with price improvement that is at least $0.005 better than the NBBO (i.e., 10% of the $0.05 tick size); and (3) certain negotiated trades (i.e., trades with a performance target such as volume-weighted average price trades and time-weighted average price trades;[57] and qualified contingent trades;[58]) could continue to occur at any price increment that is permitted today.

57 A volume-weighted average price trade is calculated by summing up the products of the number of shares traded and the respective share price, and dividing by the total number of shares bought. A time-weighted average price trade is calculated as the average price of a security over a specified period of time.

58 A qualified contingent trade is a transaction consisting of two or more component orders, executed as agent or principal, where: (1) at least one component order is in an NMS stock; (2) all components are effected with a product or price contingency that either has been agreed to by the respective counterparties or arranged for by a broker-dealer as principal or agent; (3) the execution of one component is contingent upon the execution of all other components at or near the same time; (4) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined at the time the contingent order is placed; (5) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or since cancelled; (6) the transaction is fully hedged (without regard to any prior existing position) as a result of the other components of the contingent trade; and (7) the transaction that is part of a contingent trade involves at least 10,000 shares or has a market value of at least $200,000.

The Commission preliminarily believes that changing the quoting increment alone may not be adequate to test the effects of larger tick size. The Commission preliminarily believes that if the minimum quoting increment is changed without corresponding changes to the minimum trading increment, market participants may be hesitant to display liquidity because of the ability to step ahead of wider quotes. Therefore, the Commission preliminarily believes that a test group should be established to examine this potential impact on displayed liquidity in conjunction with Test Group One.[59] The Commission also preliminarily believes that limited exceptions to the trading increment should be allowed so as not to prohibit certain categories of trades that are broadly beneficial to market participants today. First, negotiated trades such as volume-weighted average price trades or time-weighted average price trades are used to execute a trading strategy over volume or time. By their definition, the price to be executed with these negotiated trades would not be at the NBBO or a $0.05 increment.[60] In addition, retail orders often receive price improvement to the benefit of retail investors.[61] The Commission preliminarily believes that preserving retail investors' ability to receive price improvement on

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[59] A pilot with Test Group Two alone cannot examine the issue. A comparison of Test Group Two to Test Group One can test the incremental effect of adding trading increments to wider quoting increments.

[60] The Commission staff has previously stated that, with respect to Rule 612 of Regulation NMS a performance target is not generally a price subject to Rule 612 as long as it is not used analogously to a limit price for ranking or displaying an order. However, if the performance target were an explicit impermissible sub-penny price and also served as a limit price, then accepting the order would be a violation. Similarly, if the customer specifies a limit price in addition to the performance target, the limit price must meet the requirements of the Rule. Available at (http://www.sec.gov/divisions/marketreg/subpenny612faq.htm). The negotiated trade exception contained herein would be subject to the same general principle, i.e., the trades must not be designed to explicitly circumvent the trading increment.

[61] See e.g., BATS BYX Rule 11.24; Nasdaq Rule 4780; NYSE Rule 107C; NYSE Arca Equities Rule 7.44; and NYSE MKT Rule 107C.

their orders would limit a potential negative impact of the Pilot on costs for retail investors.[62] The Commission preliminarily believes that changing the quoting increment and trading increment for Test Group Two could generate useful data on the effects of quoting and trading increments on the Pilot Securities.

- **Test Group Three.** Pilot Securities in Test Group Three would be subject to the same minimum quoting and trading increments (and exceptions thereto) as Test Group Two, but in addition would be subject to a "trade-at" requirement. Generally, a trade-at requirement is intended to prevent price matching by a trading center not displaying the NBBO. Under a trade-at requirement, a trading center that was not displaying the NBBO at the time it received an incoming marketable order could: (1) execute the order with significant price improvement (such as the minimum allowable $0.05 increment or the mid-point between the NBBO),[63] (2) execute the order at the NBBO with significant size improvement if the size of the order was of block

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[62] Today, retail investors typically receive price improvement on their orders over the NBBO. The Concept Release noted that in 2009, the eight broker-dealers with significant retail customer accounts route nearly 100% of their customer market orders to over-the-counter market makers for execution. See Concept Release, supra note 14. See also Letters from David Weisberger, Executive Principal, Two Sigma Securities, dated April 23, 2013 ("As a further protection against increased costs, the Commission should continue to permit executions at prices between the minimum quoting increments. Banning such executions would not only add to the complexity of evaluating the pilot's results, but would effectively deprive retail and institutional investors of an opportunity to receive price improvement.") to Elizabeth Murphy, Secretary, Commission; and Paul Jiganti, Managing Director, Market Structure and Client Advocacy, TD Ameritrade dated October 31, 2013 ("If there is going to be a tick size pilot program, we recommend that it is controlled, limited in scope and time, and one that does not compromise the benefits retail customers receive from Regulation NMS.") to the Honorable Mary Jo White, Chair, Commission. But see letter from Joseph Saluzzi, Partner, Themis Trading LLC, dated November 20, 2013 (recommending that the trading increments under a pilot be limited to the bid, the offer or the mid-point between the two. "Allowing internalizers to jump ahead of displayed liquidity for de minimis price improvement would continue to discourage displayed liquidity and harm the price discovery process.").

[63] For retail investor orders, trading centers would be required to provide the minimum price improvement of 10% of the $0.05 tick size as described under Test Group 2.

size[64], or (3) route intermarket sweep orders[65] to execute against the full displayed size of protected quotations at the NBBO and then execute the balance of the order at the NBBO price. The Commission preliminarily believes that a trade-at requirement should be included in the Pilot.[66] When quoting and trading increments are widened in the absence of a trade-at requirement, the Commission preliminarily believes there is a possibility trading volume could migrate away from "lit venues" -- trading venues that provide public pre-trade transparency by displaying the best-priced quotations – to "dark venues" that do not provide such public pre-trade price transparency. The percentage of trading volume executed in dark venues has increased in recent years. In 2009, trading volume executed in dark venues was approximately 25 percent. Today, it is approximately 35 percent.[67] The Commission believes that if trading

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64 Block size refers to an order that is (1) at least 10,000 shares or (2) for a quantity of stock having a market value of at least $200,000. See Rule 600(b)(9) of Regulation NMS, 17 CFR 242.600(b)(9).

65 Intermarket sweep orders are exceptions provided in Rule 611(b)(5) and (6) of Regulation NMS that enable an order router to sweep one or more price levels simultaneously at multiple trading centers without violating trade-through restrictions. As defined in Rule 600(b)(30) of Regulation NMS, intermarket sweep orders must be routed to execute against the full displayed size of any protected quotation that otherwise would be traded through by the orders. See also Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS, Question 4.04 (April 4, 2008 Update) (available at http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm).

66 One commenter supports the inclusion of a trade-at requirement in a tick pilot. See letter from Christopher Nagy, CEO, and David Lauer, President, KOR Group LLC, to Ms. Murphy, Commission, dated April 4, 2014.

67 See OTC Trading: Description of Non-ATS OTC Trading in National Market System Stocks by Laura Tuttle, March 2014 (available at http://www.sec.gov/marketstructure/research/otc_trading_march_2014.pdf); Equity Market Structure Literature Review Part I: Market Fragmentation by Staff of the Division of Trading and Markets, October 7, 2013 (available at http://www.sec.gov/marketstructure/research/fragmentation-lit-review-100713.pdf); and Alternative Trading Systems: Description of ATS Trading in National Market System Stocks by Laura Tuttle, October 2013 (available at

volume in Test Group Two Pilot Securities moves to undisplayed trading centers, then including the trade-at requirement in Test Group Three could test whether trading remains on lit venues and what impact, if any, the migration of trading from lit venues to dark venues would have on liquidity and market quality for the Pilot Securities.

Therefore, the Commission preliminarily believes that the Pilot should test whether a trade-at requirement would stem the potential migration of trading volume away from these lit venues. The inclusion of a trade-at requirement would allow the Commission generate and analyze data on the impact of a trade-at requirement in conjunction with wider tick sizes. In particular, a comparison of Test Group Three to Test Group Two would provide insight into the incremental effects of a trade-at requirement.

- **SRO Data for the Tick Size Pilot.** The Commission preliminarily believes that the following data should be collected and transmitted to the Commission and made available to the public in an agreed-upon format on the frequency noted below. The Commission intends to study such data to assess the impact of the changes made under the Pilot. The Commission believes that making the data available to the public, in an agreed-upon format would facilitate the public's ability to assess the impact of the pilot.

  - **Identification of Pilot Securities**. On each day during the Pilot, the primary listing exchanges should make publicly available the list of stocks included in each Test Group, adjusting for ticker symbol changes and relevant corporate actions, as set forth in Annex A.

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http://www.sec.gov/marketstructure/research/alternative-trading-systems-march-2014.pdf).

- **Pilot Data.** The Commission preliminarily believes that the Participants should provide to the Commission the data set forth in Annex B or explain in the NMS Plan any data alternatives that would to the same extent facilitate the studies of the effect of tick size mentioned in this order. All data must be provided in an agreed-upon format, on a monthly basis and made publicly available. The data should be provided for dates starting six months prior to the Pilot period through six months after the end of the Pilot period. The Commission intends to study such data to assess the impact of the changes made under the Pilot.

- **Assessments.** The Commission preliminarily believes that the Participants, either individually or jointly, should provide to the Commission and make publicly available their assessment of the impact of the Pilot no later than six months after the end of the Pilot Period, as follows:

A. Assess the statistical and economic impact of an increase in the quoting increment on market quality.

B. Assess the statistical and economic impact of an increase in the quoting increment on the number of market makers [68]

C. Assess the statistical and economic impact of an increase in the quoting increment on market maker participation.

D. Assess the statistical and economic impact of an increase in the quoting increment on market maker profits.

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[68] The term "market makers" includes all registered market makers and other registered liquidity providers.

E. Assess the statistical and economic impact of an increase in the quoting increment on market transparency.

F. Evaluate whether any thresholds can differentiate the results of the above assessments across stocks. (e.g., whether stocks above the threshold have negative effects while stocks below the threshold have positive effects)

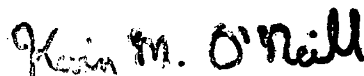
G. Assess the statistical and economic impact of the above assessments for the incremental impact of a trading increment and for the joint effect of an increase in a quoting increment with the addition of a trading increment.

H. Assess the statistical and economic impact of the above assessments for the incremental impact of a trade-at rule and for the joint effect of an increase in a quoting increment with the addition of a trading increment and a trade-at rule.

I. Assess any other economic issues that the Participants believe the Commission should consider in any rulemaking that may follow the Pilot.

IT IS HEREBY ORDERED, pursuant to Section 11A(a)(3)(B) of the Act,[69] that the Participants act jointly in developing and filing with the Commission, as an NMS plan pursuant to Rule 608(a) of Regulation NMS,[70] a Tick Size Pilot Plan, as described above. The Participants are ordered to file with the Commission such Tick Size Pilot Plan no later than [60] days after the issuance of this Order.

By the Commission.



Kevin M. O'Neill
Deputy Secretary

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69 15 U.S.C. 78k-1(a)(3)(B).

70 17 CFR 242.608(a).

Annex A

These datasets can include additional fields as agreed upon by the Participants.

1. A dataset identifying pilot stocks containing the following fields in a pipe delimited format with the field names as the first record. The SROs should use consistent file name formats.

    a) Ticker Symbol

    b) Security Name

    c) Listing Exchange

    d) Date

    e) Tick Size Pilot Group – character value of

        1) "C" for stocks in the Control Group

        2) "G1" for stocks in Test Group One

        3) "G2" for stocks in Test Group Two

        4) "G3" for stocks in Test Group Three

2. A dataset that identifies changes in the pilot ticker symbols on that day containing the following fields and in a pipe delimited format with field names as the first record. The SROs should use consistent file name formats.

    a) Ticker Symbol

    b) Security Name

    c) Listing Exchange

    d) Effective Date

    e) Deleted Date

    f) Tick Size Pilot Group – character value of

        1) "C" for stocks in the Control Group

2) "G1" for stocks in Test Group One

3) "G2" for stocks in Test Group Two

4) "G3" for stocks in Test Group Three

g) Old Ticker Symbol(s)

f) Reason for the change – character value agreed upon by SROs

Annex B

These datasets can include additional fields as agreed upon by the SROs. The data need only include stocks meeting the thresholds for inclusion in one of the three Test Groups and the Control Group as of the date of selection.

A dataset of daily market quality statistics of orders by security, order type, original order size (as observed by SRO), hidden status, and coverage under Rule 605 in a pipe delimited format with field names as the first record:

1. Minimum Fields: same as Rule 605 fields, except as modified below, and, as defined below, Rule 605 Coverage, Hidden Status, Original Percentage Hidden, and Final Percentage Hidden.
2. The SRO should include only orders executed on their exchanges (or OTC in the case of FINRA).
3. The order size should be the original order size as observed by the SRO.
4. Modified order size categories (slightly different than Rule 605): less than 100, 100 to 499 shares, 500 to 1999 shares, 2000 to 4999 shares, 5000 to 9999 shares, and 10000 or greater shares.
5. Modified execution speed categories include: orders executed from 0 to <100 microseconds, 100 microseconds to <100 milliseconds, 100 milliseconds to < 1 second, 1 second to <30 seconds, 30 seconds to <60 seconds, 60 seconds to < 5 minutes, 5 minutes to 30 minutes.
6. Hidden status should include orders for which the instructions indicate that the order is not displayable in part or full.

a) Hidden status is a character variable with the values "entirely displayable," "partially displayable," and "not displayable" or other values as agreed upon by the SROs.

b) Original Percentage Hidden is the percentage of shares not displayable as of order receipt, regardless of its placement relative to the quotes. For example, a buy order for 5000 shares with an instruction to not display 4000 shares would be 80% hidden regardless of whether it is greater than or less than the bid price.

c) Final Percentage Hidden is the percentage of shares not displayed prior to final order execution or cancellations. For example, suppose a buy order for 5000 shares with an instruction to display not more than 1000 shares at a time. After the first 1000 shares execute a second 1000 is displayed. If the order is cancelled before any more executions, the final percentage hidden is 60%.

7. Orders to include: Market orders, marketable limit orders, inside-the-quote limit orders, at-the-quote limit orders, near-the-quote limit orders, and intermarket sweep orders (ISOs), including those not covered by Rule 605.

8. Rule 605 coverage: indicate whether the order is covered in Rule 605 ("Yes") or reason for not covered (character variable with the consistent values across SROs such as "opening", "closing", "stop price", "full size", "short sale", "other tick/bid sensitive", "not held", "special settlement", "non-market," "order size > 10,000", or other values as agreed upon by SROs)

A dataset of daily number of registered market makers[71] by security in a pipe delimited format with field names as the first record:

1. Minimum fields: SRO, number of registered market makers, number of other registered liquidity suppliers.

A dataset of daily market maker participation and trading profits of orders by security in a pipe delimited format with field names as the first record:

1. Minimum fields: SRO, total market maker share participation, total market maker trade participation, cross-quote market maker share participation, cross-quote market maker trade participation, inside-the-quote market maker share participation, inside-the-quote market maker trade participation, at-the-quote market maker share participation, at-the-quote market maker trade participation, outside-the-quote market maker share participation, outside-the-quote market maker trade participation, raw market maker realized trading profits, market maker realized trading profits net of fees and rebates, raw market maker unrealized trading profits.
2. Participation fields:
   a) Share participation: the number of shares purchased or sold by market makers in a principal trade, not including riskless principal. When aggregating across market makers, this should be a share-weighted average per market maker.
   b) Trade participation: the number of purchases and sales by market makers in a principal trade, not including riskless principal. When aggregating across market makers, this should be a trade-weighted average per market maker.

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71 The term "market makers" includes all registered market makers and other registered liquidity providers.

c) Cross-quote participation refers to the market maker buying at or above the national best offer or selling at or below the national best bid at the time of the trade.

d) Inside-the-quote participation refers to a trade price that is between the national best bid and offer prices at the time of the trade.

e) At-the-quote (outside-the-quote) participation refers to a buy price that is equal to (less than) the national best bid price at the time of or immediately before the trade. In the case of downward moving national best bid, use the national best bid price immediately before the trade. Otherwise, use the national best bid price at the time of trade. For a sell price, use the same method with the national best offer price.

3. Trading profit fields:

a) Realized trading profits are the difference between the market value of market maker sales (shares sold × price) and the market value of market maker purchases (shares purchased × price). Use a LIFO-like method for determining which share prices to use in the calculation. When aggregating across market makers, this should be a share-weighted average per market maker.

b) Realized trading profits net of fees and rebates are the realized trading profits plus rebates the market maker collects from trading on that day minus access fees the market maker pays for trading on that day. If estimated before allocations of rebates and fees, use expected rebates and fees.

c) Unrealized trading profits are the difference between the purchase or sale price of the end-of-day inventory position of the market maker and the official closing

price. In the case of a short position, subtract the closing price from the sale price. In the case of a long position, subtract the purchase price from the closing price.

A dataset of market orders and marketable limit orders in a pipe delimited format with field names as the first record.

1. Minimum fields: ticker symbol, date, order receipt time, order type, order size in shares, order side ("B", "S", or "SS"), order price (if marketable limit), NB quoted price, NB quoted depth in lots, receiving market offer for buy or bid for sell, receiving market depth (offer for buy and bid for sell), indicator for quote leader, average execution price (share-weighted), executed shares, canceled shares, routed shares, routed average execution price (share-weighted), indicator for special handling instructions.
2. Quote variables:
   a) NB quoted price is the national best offer for buys and the national best bid for sells.
   b) NB quoted depth is the NBO depth for buys and NBB depth for sells.
   c) The indicator for quote leader is 1 if the receiving market was the first market to post the NBB for a sell or NBO for a buy.
3. Average execution price is a share-weighted average that includes only executions on the receiving market. Routed average execution price is a share-weighted average that includes only shares routed away from the receiving market.
4. Routed shares refers to the number of shares in the order that were routed to another exchange or market.

5. The indicator for special handling instructions should identify orders that contain instructions that could result in delayed execution or an execution price other than the quote.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 241, and 250

[Release No. 34-72472; File No. S7-02-13]

RIN 3235-AL25

Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities

AGENCY: Securities and Exchange Commission.

ACTION: Final rules; interpretation.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is adopting rules and providing guidance to address the application of certain provisions of the Securities Exchange Act of 1934 ("Exchange Act") that were added by Subtitle B of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), to cross-border security-based swap activities. These rules and guidance in large part focus on the application of the Title VII definitions of "security-based swap dealer" and "major security-based swap participant" in the cross-border context. The Commission also is adopting a procedural rule related to the submission of applications for substituted compliance. In addition, the Commission is adopting a rule addressing the scope of our authority, with respect to enforcement proceedings, under section 929P of the Dodd-Frank Act.

EFFECTIVE DATE: [Insert date 60 days after publication in the Federal Register.]

FOR FURTHER INFORMATION CONTACT: Richard Gabbert, Senior Special Counsel, Joshua Kans, Senior Special Counsel, or Margaret Rubin, Special Counsel, Office of Derivatives Policy, at 202-551-5870, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is adopting the following rules under the Exchange Act, accompanied by related guidance, regarding the application of Subtitle B of Title VII of the Dodd-Frank Act to cross-border activities: Rule 0-13 (filing procedures regarding substituted compliance requests); Rule 3a67-10 (regarding the cross-border implementation of the "major security-based swap participant" definition); Rule 3a71-3 (regarding the cross-border implementation of the de minimis exception to the "security-based swap dealer" definition); Rule 3a71-4 (regarding the cross-border implementation of the aggregation provisions of the dealer de minimis exception); and Rule 3a71-5 (regarding an exception, from the dealer de minimis analysis, for certain cleared anonymous transactions). The Commission is not addressing, as part of this release, certain other rules that we proposed regarding the application of Subtitle B of Title VII in the cross-border context. The Commission also is adopting Rule 250.1 to clarify the scope of its antifraud civil law-enforcement authority, with respect to enforcement proceedings, in the cross-border context.

Table of Contents

I. Background 1
A. Scope of this Rulemaking 1
B. The Dodd-Frank Act 4
C. The Cross-Border Proposing Release and the CFTC Cross-Border Guidance 6
D. Comments on the Proposal 8
II. The Economic, Legal, and Policy Principles Guiding the Commission's Approach to the Application of Title VII to Cross-Border Activities 12
A. Economic Considerations in the Cross-Border Regulation of Security-Based Swaps 13
1. Economic Features of the Security-Based Swap Market 13
2. Context for Regulatory Determinations 20
B. Scope of Title VII's Application to Cross-Border Security-Based Swap Activity 26
1. Commenters' Views 28
2. Scope of Application of Title VII in the Cross-Border Context 29

(a) Overview and General Approach 30

(b) Territorial Approach to Application of Title VII Security-Based Swap Dealer Registration Requirements....................32

i. Dealing Activity of U.S. Persons....................35

ii. Dealing Transactions of Non-U.S. Persons that are Subject to Recourse Guarantees by their U.S. Affiliates 37

iii. Dealing Activity of Other Non-U.S. Persons 41

(c) Territorial Approach to Application of Title VII Major Security-Based Swap Participant Registration Requirements 43

(d) Regulations Necessary or Appropriate to Prevent Evasion of Title VII 46

C. Principles Guiding Final Approach to Applying "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions in the Cross-Border Context 47

III. Baseline....................50

A. Current Security-Based Swap Market....................51

1. Security-Based Swap Market Participants 52

(a) Dealing Structures 56

(b) Participant Domiciles....................57

(c) Current Estimates of Dealers and Major Participants....................60

2. Levels of Security-Based Swap Trading Activity....................63

B. Global Regulatory Efforts....................67

C. Cross-Market Participation 70

IV. Cross-Border Application of Dealer De Minimis Exception 73

A. Overview....................73

B. Application of De Minimis Exception to Dealing Activities of U.S. Persons....................78

1. Proposed Approach and Commenters' Views....................78

2. Final Rule 79

C. Definition of "U.S. Person" 81

1. Proposed Approach 81

2. Commenters' Views....................82

(a) Definition of "U.S. Person" Generally 83

(b) Treatment of Investment Vehicles....................84

(c) Treatment of Legal Persons More Generally....................86

(d) Accounts 90

(e) International Organizations 90
(f) Status Representations 92
3. Final Rule 92
(a) Natural Persons 95
(b) Corporations, Organizations, Trusts, Investment Vehicles, and Other Legal Persons 96
i. Entities incorporated, organized, or established under U.S. law 96
ii. Entities having their principal place of business in the United States 100
iii. Fund ownership 110
(c) Accounts 112
(d) Estates 114
(e) Certain International Organizations 115
4. Representations Regarding U.S.-person status 115
D. Application of De Minimis Exception to Dealing Activities of Conduit Affiliates 117
1. Proposed Approach and Commenters' Views 117
2. Final Rule 119
E. Application of De Minimis Exception to Dealing Activities of Other Non-U.S. Persons 125
1. Dealing Transactions of Non-U.S. Persons that are Subject to Recourse Guarantees by their U.S. Affiliates 126
(a) Proposed Approach and Commenters' Views 126
(b) Final Rule 128
2. Dealing Transactions of Non-U.S. Persons Involving U.S. and Other Counterparties 139
(a) Proposed Approach and Commenters' Views 139
(b) Final Rule 141
F. Application of the Exception's Aggregation Principles to Cross-Border Dealing Activity 150
1. Proposed Approach and Commenters' Views 150
2. Final Rule 153
(a) General Provisions Regarding Aggregation of Cross-Border Transactions 153
(b) Application to Dealing Activities of Registered Affiliates 155
G. Exception for Cleared Anonymous Transactions 157
1. Proposed Approach and Commenters' Views 157

2. Final Rule 158
H. Additional Issues 160
1. Particular Activities and Entities 160
2. Foreign Public Sector Financial Institutions and Government-Related Entities 161
I. Economic Analysis of the Final Cross-Border Dealer De Minimis Rule 163
1. Programmatic Costs and Benefits 166
(a) Cost-benefit Considerations of the Final Rules 166
(b) Evaluation of Programmatic Impacts 172
2. Assessment Costs 178
(a) Legal Costs 180
(b) Costs related to Systems, Analysis, and Representations 183
(c) Overall Considerations Related to Assessment Costs 188
3. Alternative Approaches 191
(a) Dealing Activity by Foreign Branches of U.S. Banks 192
(b) Dealing Activity by Guaranteed Affiliates of U.S. Persons 193
(c) Dealing by Conduit Affiliates 196
(d) Dealing Activity by Non-U.S. Counterparties with Foreign Branches of U.S. Banks and Certain Other Counterparties 197
(e) "U.S. Person" Definition 200
(f) Aggregation Requirement 205
(g) Exception for Cleared Anonymous Transactions 207
V. Cross-Border Application of Major Security-Based Swap Participant Thresholds 208
A. Overview 208
B. Application of the Major Security-Based Swap Participant Definition to U.S. Persons 212
1. Proposed Approach and Commenters' Views 212
2. Final Rule 213
C. Application of the Major Security-Based Swap Participant Definition to Conduit Affiliates 213
1. Proposed Approach and Commenters' Views 213
2. Final Rule 214
D. Application to Other Non-U.S. Persons 218
1. Positions with U.S. Persons Other than Foreign Branches of U.S. Banks 219
(a) Proposed Approach and Commenters' Views 219

(b) Final Rule....220
2. Positions with Foreign Branches of U.S. Banks....222
(a) Proposed Approach and Commenters' Views....222
(b) Final Rule....223
3. Positions of Non-U.S. Persons that are Subject to Recourse Guarantees by a U.S. Person....225
(a) Proposed Approach and Commenters' Views....225
(b) Final Rule....227
E. Attribution....232
1. Positions Attributed to U.S. Person Guarantors....234
(a) Proposed Approach and Commenters' Views....234
(b) Final Rule....235
2. Positions Attributed to Non-U.S. Person Guarantors....237
(a) Proposed Approach and Commenters' Views....237
(b) Final Rule....237
3. Limited Circumstances Where Attribution of Guaranteed Security-Based Swap Positions Does Not Apply....240
(a) Proposed Approach and Commenters' Views....240
(b) Final Rules....241
F. Other Issues Related to the Application of the Major Security-Based Swap Participant Definition....243
1. Threshold for Registration as a Major Security-Based Swap Participant....243
2. Entities that Maintain Legacy Portfolios....244
G. Foreign Public Sector Financial Institutions and Government-Related Entities....245
H. Economic Analysis of Final Rules Regarding "Major Security-Based Swap Participants"....248
1. Programmatic Costs and Benefits....249
(a) Cost-benefit Considerations of the Final Rules....249
(b) Evaluation of Programmatic Impacts....252
2. Assessment Costs....255
(a) Legal Costs....257
(b) Costs Related to New Systems, Analysis, and Representations....260
(c) Overall Considerations Related to Assessment Costs....263
3. Alternative Approaches....265

(a) Security-based Swap Positions Held by Foreign Branches of U.S. Banks 266

(b) Positions of Non-U.S. Persons for which the Counterparty has Rights of Recourse Against a U.S. Person 267

(c) Positions of Conduit Affiliates 269

(d) Positions of Non-U.S. Persons with Foreign Branches of U.S. Banks and Certain Other Counterparties 270

(e) Attribution 272

i. Attribution to U.S. Persons 272

ii. Attribution to Non-U.S. Persons 273

(f) Positions Cleared Through a Clearing Agency in the United States 274

(g) Foreign Government-Related Entities 274

VI. Substituted Compliance Procedural Rule 275

A. Proposed Approach and Commenters' Views 275

B. Final Rule 278

C. Economic Analysis 282

VII. Antifraud Authority 285

A. Final Rule 285

B. Economic Analysis 288

VIII. Impacts on Efficiency, Competition, and Capital Formation 289

A. Competition 291

B. Efficiency 299

C. Capital Formation 303

IX. Paperwork Reduction Act 305

A. Introduction 305

B. Reliance on Counterparty Representations Regarding Transactions Conducted Through a Foreign Branch 307

1. Summary of Collection of Information 307

2. Proposed Use of Information 307

3. Respondents 308

4. Total Initial and Annual Reporting and Recordkeeping Burdens 309

C. Reliance on Counterparty Representations Regarding Non-U.S. Person Status 310

1. Summary of Collection of Information 310

2. Proposed Use of Information 311

3. Respondents 312

4. Total Initial and Annual Reporting and Recordkeeping Burdens 312
X. Regulatory Flexibility Act Certification 313
XI. Effective Date and Implementation 316
Statutory Authority and Text of Final Rules 317

I. Background

A. Scope of this Rulemaking

The Commission is adopting the first of a series of rules and providing guidance regarding the application of Title VII of the Dodd-Frank Act[1] ("Title VII") to cross-border security-based swap activities and persons engaged in those activities.[2] This rulemaking primarily focuses on the application of the de minimis exception to the definition of "security-based swap dealer" in the cross-border context, and on the application of thresholds related to the definition of "major security-based swap participant" in the cross-border context. We also are adopting a procedural rule regarding the submission of "substituted compliance" requests to allow market participants to satisfy certain Title VII obligations by complying with comparable foreign regulatory requirements.[3]

The rules and guidance we are adopting are based on our May 23, 2013 proposal, which addressed the application of Title VII in the cross-border context.[4] Aside from addressing the

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1 Public Law 111–203, 124 Stat. 1376 (2010). Unless otherwise indicated, references to Title VII in this release are to Subtitle B of Title VII.

2 Consistent with the scope of the final rules as discussed below, the references in this release to the application of Title VII to "cross-border activities" refer to security-based swap transactions involving: (i) A U.S. person and a non-U.S. person, or (ii) two non-U.S. persons conducting a security-based swap transaction that otherwise occurs in relevant part within the United States, including where performance of one or both counterparties under the security-based swap are guaranteed by a U.S. person. For purposes of this release only, "cross-border activities" do not indicate activities involving a transaction between two non-U.S. persons where one or both are conducting dealing activity within the United States, because, as discussed below, we anticipate considering this issue in a subsequent release.

3 The procedural rule addresses only the process for submitting such substituted compliance requests to the Commission. It does not address issues regarding whether substituted compliance would be available in connection with particular regulatory requirements, and, if so, under what conditions. We expect to address those matters as part of later rulemakings.

4 See Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968 (May 23, 2013) ("Cross-Border Proposing Release").

definitions and procedural rule noted above, the Cross-Border Proposing Release also addressed a range of other cross-border issues, including issues regarding the requirements applicable to dealers and major participants, and requirements relating to mandatory clearing, trade execution, regulatory reporting, and public dissemination. The Cross-Border Proposing Release stated that it was possible that we would consider final rules and guidance related to some of those issues in the adopting releases related to the relevant substantive rulemakings, and that we would address others in a separate rulemaking.[5]

This rulemaking's focus on the cross-border application of the dealer and major participant definitions reflects the critical and foundational role that those definitions occupy with regard to the implementation of Title VII.[6] We expect to address other matters raised by the Cross-Border Proposing Release as part of subsequent rulemakings, to allow us to consider the cross-border application of the substantive requirements imposed by Title VII – including the economic consequences of that cross-border application – in conjunction with the final rules that will implement those substantive requirements.[7] Market participants are not required to comply with certain of those Title VII requirements pending the publication of final rules or other

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5 See id. at 30974.

6 This rulemaking does not address the requirements under section 5 of the Securities Act applicable to security-based swap transactions. Security-based swaps, as securities, are subject to the provisions of the Securities Act of 1933 (15 U.S.C. 77a et seq.) ("Securities Act") and the rules and regulations thereunder applicable to securities. The Securities Act requires that any offer and sale of a security must either be registered under the Securities Act (see section 5 of the Securities Act, 15 U.S.C. 77e) or made pursuant to an exemption from registration (see, e.g., sections 3 and 4 of the Securities Act, 15 U.S.C. 77c and 77d, respectively). In addition, the Securities Act requires that any offer to sell, offer to buy or purchase, or purchase or sale of, a security-based swap to any person who is not an eligible contract participant must be registered under the Securities Act (see section 5(e) of the Securities Act, 15 U.S.C. 77e(e)). Because of the statutory language of section 5(e) of the Securities Act, exemptions from this requirement in sections 3 and 4 of the Securities Act are not available.

7 Those subsequent rulemakings may make use of definitions of "U.S. person" and certain other terms that we are adopting today.

Commission action, and temporarily are exempt from having to comply with certain other requirements added by or arising from Title VII.[8]

These final rules and guidance do not address one key issue related to the application of the "security-based swap dealer" definition in the cross-border context. In the Cross-Border Proposing Release, we proposed that non-U.S. persons must count, against the relevant thresholds of the de minimis exemption, their dealing activity involving "transactions conducted within the United States."[9] Commenters raised a number of significant issues related to this proposed requirement, including issues regarding the Commission's authority to impose this requirement and regarding the costs associated with this requirement. While we continue to preliminarily believe that the cross-border application of the security-based swap dealer definition should account for activities in the United States related to dealing – even when neither party to the transaction is a U.S. person – we also believe that the final resolution of this issue can benefit from further consideration and public comment. Accordingly, we anticipate soliciting additional public comment regarding approaches by which the cross-border application of the dealer definition appropriately can reflect activity between two non-U.S. persons where

8 See Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, Exchange Act Release No. 64678 (Jun. 15, 2011), 76 FR 36287 (Jun. 22, 2011) (clarifying the compliance date for certain requirements added by Title VII, and in some cases providing temporary exemptive relief in connection with those requirements); Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of "Security" to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 71485 (Feb. 5, 2014), 79 FR 7731 (Feb. 10, 2014) (extending exemptive relief from certain Exchange Act provisions in connection with Title VII's revision of the Exchange Act definition of "security" to encompass security-based swaps).

9 See proposed Exchange Act rule 3a71-3(b). The proposal further would have defined a "transaction conducted within the United States" to encompass transactions that are solicited, executed, or booked within the United States by or on behalf of either counterparty, regardless of either counterparty's location, domicile or residence status, subject to an exception for transactions conducted through the foreign branches of U.S. banks. See proposed Exchange Act rule 3a71-3(a)(5).

one or both are conducting dealing activity within the United States.

B. The Dodd-Frank Act

As discussed in the Cross-Border Proposing Release, the 2008 financial crisis highlighted significant issues in the over-the-counter ("OTC") derivatives markets, which had experienced dramatic growth in the years leading up to the crisis and are capable of affecting significant sectors of the U.S. economy.[10] 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, including in connection with swaps and security-based swaps.[11]

Title VII provides for a comprehensive new regulatory framework for swaps and security-based swaps. Under this framework, the Commodity Futures Trading Commission ("CFTC") regulates "swaps" while the Commission regulates "security-based swaps," and the Commission and CFTC jointly regulate "mixed swaps." The new framework encompasses the registration and comprehensive regulation of dealers and major participants, as well as requirements related to clearing, trade execution, regulatory reporting, and public dissemination.[12] Security-based swap transactions are largely cross-border in practice,[13] and the

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10 See generally Cross-Border Proposing Release, 78 FR at 30972-73.

11 See Pub. L. No. 111-203, Preamble (stating that the Dodd-Frank Act was enacted "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes").

12 The Commission has proposed a series of rules regarding these matters. See Cross-Border Proposing Release, 78 FR at 30972 nn.11-18. Most recently, the Commission proposed rules governing recordkeeping, reporting, and notification requirements for dealers and major participants. See Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194 (May 2, 2014).

The Dodd-Frank Act further provides that the SEC and CFTC jointly should further define certain terms, including "security-based swap dealer" and "major security-based swap participant." See Dodd-Frank Act section 712(d). Pursuant to that requirement, the SEC and CFTC jointly adopted rules to further define those terms. See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," Exchange Act Release No. 66868 (Apr. 27, 2012), 77 FR 30596 (May 23,

various market participants and infrastructures operate in a global market. To ensure that our regulatory framework appropriately reflects and addresses the nature and extent of the potential impact that the global market can have on U.S. persons and the U.S. financial system, it is critically important that we provide market participants with clear rules and guidance regarding how the regulatory framework mandated by Title VII will apply in the cross-border context.

In developing these final rules and guidance, we have consulted and coordinated with the CFTC, the prudential regulators,[14] and foreign regulatory authorities in accordance with the consultation provisions of the Dodd-Frank Act,[15] and more generally as part of our domestic and international coordination efforts.[16] Commission staff has participated in numerous bilateral and

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2012) ("Intermediary Definitions Adopting Release"); see also Cross-Border Proposing Release, 78 FR at 30972 n.9 (discussing joint rulemaking to further define various Title VII terms).

13 See section II.A, infra, regarding the preponderance of cross-border activity in the security-based swap market.

14 The term "prudential regulator" is defined in section 1a(39) of the CEA, 7 U.S.C. 1a(39), and that definition is incorporated by reference in section 3(a)(74) of the Exchange Act, 15 U.S.C. 78c(a)(74). Pursuant to the definition, the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency (collectively, the "prudential regulators") is the "prudential regulator" of a security-based swap dealer or major security-based swap participant if the entity is directly supervised by that regulator.

15 Section 712(a)(2) of the Dodd-Frank Act provides in part that the Commission shall "consult and coordinate to the extent possible with the Commodity Futures Trading Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible."

In addition, section 752(a) of the Dodd-Frank Act provides in part that "[i]n order to promote effective and consistent global regulation of swaps and security-based swaps, the Commodity Futures Trading Commission, the Securities and Exchange Commission, and the prudential regulators . . . as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps."

16 In 2009, leaders of the Group of 20 ("G20")—whose membership includes the United States, 18 other countries, and the European Union ("EU")—called for global improvements in the functioning, transparency, and regulatory oversight of OTC derivatives markets. See G20 Leaders' Statement, Pittsburgh, United States, September 24-25, 2009, available at: http://www.treasury.gov/resource-center/international/g7-

multilateral discussions with foreign regulatory authorities addressing the regulation of OTC derivatives.[17] Through these discussions and the Commission staff's participation in various international task forces and working groups,[18] we have gathered information about foreign regulatory reform efforts and the possibility of conflicts and gaps, as well as inconsistencies and overlaps, between U.S. and foreign regulatory regimes. We have taken this information into consideration in developing the final rules and guidance.

C. The Cross-Border Proposing Release and the CFTC Cross-Border Guidance

In expressing our preliminary views regarding the application of Title VII to security-based swap activity carried out in the cross-border context (including to persons engaged in such activities), the Cross-Border Proposing Release recognized that the security-based swap market is global in nature and that it developed prior to the enactment of the Dodd-Frank Act.[19] The

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g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf. ("G20 Leaders' Pittsburgh Statement").

In subsequent summits, the G20 leaders have reiterated their commitment to OTC derivatives regulatory reform. For example, in September 2013, the leaders of the G20 reaffirmed their commitments with respect to the regulation of the OTC derivatives markets, welcoming Financial Stability Board ("FSB") members' confirmed actions and committed timetables to put the agreed OTC derivatives reforms into practice. See the G20 Leaders Declaration (September 2013), para. 71, available at: https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG pdf ("G20 Leaders' St. Petersburg Declaration").

17 Senior representatives of authorities with responsibility for regulation of OTC derivatives have met on a number of occasions to discuss international coordination of OTC derivatives regulations. See, e.g., Report of the OTC Derivatives Regulators Group ("ODRG") on Cross-Border Implementation Issues March 2014 (Mar. 31, 2014), available at: http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/odrgreport033114.pdf.

18 Commission representatives participate in the FSB's Working Group on OTC Derivatives Regulation ("ODWG"), both on its own behalf and as the representative of the International Organization of Securities Commissions ("IOSCO"), which is co-chair of the ODWG. A Commission representative also serves as one of the co-chairs of the IOSCO Task Force on OTC Derivatives Regulation.

19 See Cross-Border Proposing Release, 78 FR at 30975-76.

proposal further recognized that the rules we adopt and guidance we provide regarding the cross-border application of Title VII could significantly affect the global security-based swap market.[20]

Reflecting the range of regulatory requirements that Title VII imposes upon the security-based swap market, the Cross-Border Proposing Release addressed the cross-border application of: (a) the de minimis exception to the "security-based swap dealer" definition; (b) the entity-level and transaction-level requirements applicable to security-based swap dealers (e.g., margin, capital, and business conduct requirements); (c) the "substantial position" and "substantial counterparty exposure" thresholds for the "major security-based swap participant" definition and the requirements applicable to major participants; (d) the registration of security-based swap clearing agencies and mandatory clearing requirements; (e) the registration of security-based swap execution facilities and mandatory trade execution requirements; and (f) the registration of security-based swap data repositories and regulatory reporting and public dissemination requirements. The proposal also addressed the potential for market participants to satisfy certain of those Title VII requirements by complying with comparable foreign rules as a substitute. This rulemaking establishes a process for submission of such requests.

Following the Commission's proposal, the CFTC issued guidance regarding Title VII's application to cross-border swap activity.[21] The CFTC Cross-Border Guidance differed from the Commission's proposed rules in certain ways, including, as discussed below, with regard to the meaning of "U.S. person," the cross-border application of the de minimis exception to the dealer

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[20] See id. at 30975.

[21] See "Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations" (Jul. 17, 2013), 78 FR 45292 (Jul. 26, 2013) ("CFTC Cross-Border Guidance").

definition, the cross-border application of the major participant definition, and the process for submitting substituted compliance requests.[22]

Certain foreign regulators also have addressed or are in the process of addressing issues related to the cross-border implementation of requirements applicable to OTC derivatives.[23]

D. Comments on the Proposal

The Commission received 36 comments in connection with the proposal.[24] Several of the commenters addressed differences between the SEC's proposed rules and the CFTC Cross-Border Guidance, and urged the Commission to harmonize its rules with the approaches taken by the CFTC and by foreign regulators.[25]

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22 The CFTC Cross-Border Guidance currently is subject to legal challenge. See Complaint, Securities Indus. & Fin. Mkts. Ass'n. v. CFTC, No. 1:13-cv-1916 (D.D.C. filed Dec. 4, 2013).

23 See section III.B, infra.

24 The comment letters are located at: http://www.sec.gov/comments/s7-02-13/s70213.shtml. The majority of those commenters addressed, at least in part, the definitional issues that are the subject of this release. A number of commenters also addressed aspects of the proposal that are outside the scope of this release, and a few of those commenters only addressed issues that were outside the scope of this release (for example, addressing only proposed Regulation SBSR). We will consider those comments in connection with the relevant rulemakings.

25 See, e.g., Managed Funds Assoc. and Alternative Investment Management Assoc. ("MFA/AIMA") Letter at 3 ("We recognize that there are differences between the Commission's proposed approach and the CFTC Cross-Border Guidance, and we expect that other international regulators will similarly issue proposals related to the cross-border application of their regulations. Thus, in light of the global nature of the derivatives market, we urge continued harmonization with the CFTC and other regulatory authorities with respect to the extraterritorial scope of all these regimes. In particular, we encourage international coordination of substituted compliance regimes to ensure appropriate recognition of comparable regulations, create practical and administrable frameworks, and alleviate duplicative regulation." (footnotes omitted)). See also letter from six members of the United States Senate at 2 (stating that there should be no gaps or loopholes between the Commission's and the CFTC's rules); Futures and Options Association ("FOA") Letter at 8 (urging the Commission and the CFTC "to coordinate, to the extent possible, on their approaches in order to minimise distortions or other unintended consequences for market participants"); letter from Senator Jeffrey A. Merkley, et al., Congress of the United States (Aug. 6, 2013).

Some commenters generally suggested that we harmonize with aspects of the CFTC Cross-Border Guidance, but also expressed preferences for particular elements of our proposed approach. See, e.g., Institute of International Bankers ("IIB") Letter at 3-4 (generally

Many of those commenters particularly focused on differences between the two regulators' meanings of the term "U.S. person," with several suggesting that we change our proposed definition to align with the CFTC's approach.[26] A number of commenters also addressed the definition of "transaction conducted within the United States," with several opposing any use of the concept as part of the Commission's rules.[27]

Commenters further raised a number of more general concerns in connection with the proposal, including concerns regarding cost-benefit issues,[28] the clarity of the proposal as a

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emphasizing the need for consistency with the CFTC and European Securities and Markets Authority ("ESMA") approaches, unless the SEC requirement is more flexible than those other requirements). One commenter took the view that the Commission's rules should be at least as strong as the CFTC Cross-Border Guidance, but should go further than the CFTC wherever necessary. See Better Markets ("BM") Letter. See also Chris Barnard Letter at 2 (recommending that the Commission and the CFTC propose one set of rules applicable to cross-border activities to avoid duplicative and conflicting rules).

[26] See notes 192-224, infra, and accompanying text.

[27] As noted above, these final rules and guidance do not address the application of the "transaction conducted within the United States" concept to the dealer definition. We instead anticipate soliciting additional public comment regarding the issue.

[28] For example, a few commenters took the view that cost-benefit principles weighed in favor of consistency with the CFTC Cross-Border Guidance. See Securities Industry and Financial Markets Association/Futures Industry Association/Financial Services Roundtable ("SIFMA/FIA/FSR") Letter at 3; PensionsEurope Letter (incorporating by reference SIFMA/FIA/FSR Letter; all references to SIFMA/FIA/FSR Letter incorporate reference to PensionsEurope Letter); IIB Letter at 2, 3. One commenter further took the view that cost-benefit principles merited rejection of the use of the "transaction conducted within the United States" concept. See SIFMA/FIA/FSR Letter at 3. See also Chris Barnard Letter at 2 (suggesting that there is insufficient administrative, legal, or economic rationale for having "very different rules" of cross-border application between the SEC and the CFTC); Coalition for Derivatives End-Users ("CDEU") Letter at 2 (stating that conflicting regulatory regimes will result in increased compliance and regulatory costs and an inefficient financial system); Association of Financial Guaranty Insurers ("AFGI") Letter, dated August 20, 2013 ("AFGI Letter I") at 2 (stating that the security-based swap dealer and major security-based swap participant regime would be disruptive and have financial consequences for guaranty insurers and their counterparties who have legacy transactions with a projected run-off date in the near future); AFGI letter, dated July 22, 2013 ("AFGI Letter II") at 4 (incorporated by reference in AFGI Letter I); AFGI letter, dated February 15, 2013 ("AFGI Letter III") at 4 (incorporated by reference in AFGI Letter I).

One commenter conversely argued that, in lieu of cost-benefit principles, the Commission instead should be guided by public interest and investor protection principles, as well as the Dodd-Frank

whole,[29] the link between the rules and the location of the associated risk,[30] and perceived concessions to the financial industry.[31]

In addition, commenters addressed issues specific to the cross-border application of the entity-level and transaction-level requirements for dealers,[32] as well as requirements specific to clearing, trade execution, regulatory reporting and public disclosure.[33] We expect to address those comments regarding the relevant substantive requirements in subsequent rulemakings and guidance regarding the relevant substantive requirements.

Act's intent to increase financial system soundness and prevent another financial crisis. See BM Letter at 4, 37-45 (stating, inter alia, that "Congress passed the Dodd-Frank Act knowing full well that it would impose significant costs on industry, yet it determined those costs were not only justified but necessary to stabilize our financial system and avoid another financial crisis").

One commenter challenged the adequacy – indeed, the existence – of the cost-benefit analysis in the proposing release. See CDEU Letter at 6 ("To better understand the negative effects of imposing conflicting rules on the market, the SEC should conduct a direct cost-benefit analysis of the conflicting rule regimes (e.g., with the European Market Infrastructure Regulation and the CFTC's cross-border guidance). Instead, the SEC asks the public to conduct such an analysis for the SEC: 'what would be the economic impact, including the costs and benefits, of these differences on market participants. . .?'").

29 See BM Letter at 2-3, 7-8; CDEU Letter at 5.

30 See Americans for Financial Reform ("AFR") Letter, dated August 22, 2013 ("AFR Letter I") at 3-4 (criticizing the proposal as having failed to apply the rules based on the geographic location of the entity ultimately responsible for the resulting liabilities, and stating that the rules should apply to transactions engaged in by "guaranteed foreign subsidiaries of U.S. entities").

31 See BM Letter at 7-8 (stating that the proposal was the result of unwarranted and inappropriate concessions, such as with regard to the application of the de minimis threshold to U.S.-guaranteed entities). See also Karim Shariff letter at 1 (stating that the proposal will allow banks to take risks that will lead to an economic collapse).

32 See, e.g., BM Letter at 3, 20-21, 28 (stating that transactions conducted through foreign branches of U.S. dealers with non-U.S. persons should be subject to external business conduct requirements, and that margin should be treated as a transaction-level requirement); SIFMA/FIA/FSR Letter at A-22 to A-26 (addressing application of margin, segregation, external business conduct and certain other requirements).

33 See, e.g., BM Letter at 3, 21-22 (criticizing exceptions from mandatory clearing and trade execution requirements); SIFMA/FIA/FSR Letter at A-38 to A-52 (in part urging that application of regulatory reporting, public dissemination, trade execution and clearing requirements should follow the same rules as external business conduct requirements).

Commenters also addressed the proposed availability of substituted compliance.[34] Although today we are adopting a procedural rule regarding requests for substituted compliance, we generally expect to address the potential availability of substituted compliance for specific Title VII requirements in connection with subsequent rulemakings regarding each substantive requirement.

We have carefully considered the comments received in adopting the final rules and providing guidance. Our final rules and guidance further reflect consultation with the CFTC, prudential regulators, and foreign regulatory authorities with regard to the development of consistent and comparable standards. Accordingly, certain aspects of the final rules and guidance – such as, for example, the treatment of guaranteed affiliates of U.S. persons for purposes of the dealer de minimis exception – have been modified from the proposal.[35]

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34 See, e.g., AFR Letter I at 8, 12 (opposing rationale for substituted compliance, and noting need for the Commission to retain discretion to find a lack of comparability based on substantive enforcement issues); AFR letter to CFTC, dated August 27, 2012 ("AFR Letter II") (stating that CFTC should narrow the scope of substituted compliance) (incorporated by reference in AFR Letter I); Michael Greenberger letter to CFTC, dated February 6, 2013 at 13 ("Greenberger Letter I") (stating that substituted compliance should be a last resort and that the CFTC regime be enforced vigorously) (incorporated by reference in AFR Letter I); Michael Greenberger letter to CFTC, dated August 27, 2012 at 8, 19-23 ("Greenberger Letter II") (explaining that international comity does not require that the CFTC exempt foreign subsidiaries from compliance with U.S. financial regulation) (incorporated by reference in AFR Letter I); BM Letter at 3, 26-27 (questioning authority for substituted compliance and suggesting potential for loopholes; also stating that substituted compliance should not be allowed for transactions with U.S. persons or for transactions in the United States and urging limited use of exemptive authority; further stating that the proposal gave only passing reference to foreign supervision and enforcement); SIFMA/FIA/FSR Letter at A-30 to A-38 (in part supporting the approach to focus on similar regulatory objectives rather than requiring foreign rules to be identical, stating that foreign branches should be able to make use of substituted compliance for certain purposes, stating that variations in foreign supervisory practices should not be assumed to be defects, and requesting further clarity regarding substituted compliance assessment factors); ESMA Letter at 1, 3-4 (suggesting particular expansions of the proposed scope of substituted compliance); European Commission ("EC") Letter (supporting "holistic" approach toward substituted compliance based on comparison of regulatory outcomes).

35 In this regard, the final rules in a number of areas take approaches that are similar to the approaches taken by the CFTC in its own cross-border guidance, although independent

II. The Economic, Legal, and Policy Principles Guiding the Commission's Approach to the Application of Title VII to Cross-Border Activities

In this section, we describe the most significant economic considerations regarding the security-based swap market that we have taken into account in implementing the cross-border application of the security-based swap dealer and major security-based swap participant definitions of Title VII. We are sensitive to the economic consequences and effects, including costs and benefits, of our rules, including with respect to the scope of our application of the security-based swap dealer and major security-based swap participant definitions in the cross-border context. We have taken into consideration the costs and benefits associated with persons being brought within one of these definitions through our cross-border application, as well as the costs market participants may incur in determining whether they are within the scope of these definitions and thus subject to Title VII, while recognizing that the ultimate economic impact of these definitions will be determined in part by the final rules regarding the substantive requirements applicable to security-based swap dealers and major security-based swap participants. Some of these economic consequences and effects stem from statutory mandates, while others result from the discretion we exercise in implementing the mandates.

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considerations have driven our approaches. Moreover, throughout the Cross-Border Proposing Release we recognized and solicited comment on the differences between our proposal and the CFTC's proposed guidance on the cross-border application of swap regulation. As noted above, many commenters urged harmonization with various aspects of the CFTC's guidance. We have taken these comments into account, and in developing final rules we have carefully considered the CFTC's guidance and the underlying policy rationales. Further, where we have determined such policy rationales and approaches are applicable in the context of the market for security-based swaps, we have adopted similar approaches to the CFTC (see, e.g., application of the de minimis exception to non-U.S. persons' dealing transactions with foreign branches of U.S. banks).

A. Economic Considerations in the Cross-Border Regulation of Security-Based Swaps

1. Economic Features of the Security-Based Swap Market

As noted above, the cross-border implementation of the rules defining security-based swap dealer and major security-based swap participant is the first in a series of final rules that consider the cross-border implications of security-based swaps and Title VII. In determining how Title VII security-based swap dealer and major security-based swap participant definitions should apply to persons and transactions in the cross-border context, the Commission has been informed by our analysis of current market activity, including the extent of cross-border trading activity in the security-based swap market. Several key features of the market inform our analysis.

First, the security-based swap market is a global market. Security-based swap business currently takes place across national borders, with agreements negotiated and executed between counterparties often in different jurisdictions (and at times booked, managed, and hedged in still other jurisdictions). The global nature of the security-based swap market is evidenced by the data available to the Commission.[36] Based on market data in the Depository Trust and Clearing Corporation's Trade Information Warehouse ("DTCC-TIW"),[37] viewed from the perspective of the domiciles of the counterparties booking credit default swap ("CDS") transactions, approximately 48 percent of price forming North American corporate single-name CDS transactions[38] from January 2008 to December 2012 were cross-border transactions between a

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[36] See section III.A.2, infra (discussing in detail the global nature of the security-based swap market).

[37] The information was made available to the Commission under an agreement with the DTCC-TIW and in accordance with guidance provided to DTCC-TIW by the OTC Derivatives Regulatory Forum ("ODRF").

[38] This figure is based on all price-forming DTCC-TIW North American corporate single-name CDS transactions. Price-forming transactions include all new transactions, assignments,

U.S.-domiciled[39] counterparty and a foreign-domiciled counterparty[40] and an additional 39 percent of such CDS transactions were between two foreign-domiciled counterparties.[41] Thus, approximately 13 percent of the North American corporate single-name CDS transactions in 2008-2012 were between two U.S.-domiciled counterparties.[42] These statistics indicate that, rather than being an exception, cross-border North American corporate single-name CDS

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modifications to increase the notional amounts of previously executed transactions, and terminations of previously executed transactions. Transactions terminated, transactions entered into in connection with a compression exercise, and expiration of contracts at maturity are not considered price-forming and are therefore excluded, as are replacement trades and all bookkeeping-related trades.

"North American corporate single-name CDS transactions" are classified as such because they use The International Swaps and Derivatives Association, Inc. ("ISDA") North American documentation. These may include certain transactions involving non-U.S. reference entities. We do not have sufficiently reliable data on reference entity domicile (as opposed to counterparty domicile, which we have sought to identify in the manner described in note 39, infra) to limit our analysis to only U.S. single-name CDS. Although the inclusion of transactions involving such non-U.S. reference entities introduces some noise into the data, we do not believe that this noise is sufficiently significant to alter the conclusions we draw from the data.

[39] The domicile classifications in DTCC-TIW are based on the market participants' own reporting and have not been verified by Commission staff. Prior to enactment of the Dodd-Frank Act, funds and accounts did not formally report their domicile to DTCC-TIW because there was no systematic requirement to do so. After enactment of the Dodd-Frank Act, the DTCC-TIW has collected the registered office location of the account or fund. This information is self-reported on a voluntary basis. It is possible that some market participants may misclassify their domicile status because the databases in DTCC-TIW do not assign a unique legal entity identifier to each separate entity. It is also possible that the domicile classifications may not correspond precisely to treatment as a U.S. person under the rules adopted today. Notwithstanding these limitations, we believe that the cross-border and foreign activity presented in the analysis by the Commission's Division of Economic and Risk Analysis demonstrates the nature of the single-name CDS market. See section III.A.2, infra.

[40] DTCC-TIW classifies a foreign branch or foreign subsidiary of a U.S.-domiciled entity as foreign-domiciled. Therefore, CDS transactions classified as involving a foreign-domiciled counterparty in the DTCC-TIW data may include CDS transactions with a foreign branch or foreign subsidiary of a U.S.-domiciled entity as counterparty.

[41] Put another way, between 2008 and 2012, a vast majority (approximately 87 percent) of North American corporate single-name CDS transactions directly involved at least one foreign-domiciled counterparty. This observation is based on the data compiled by the Commission's Division of Economic and Risk Analysis on North American corporate single-name CDS transactions from DTCC-TIW between January 1, 2008, and December 31, 2012. See section III.A.2, infra.

[42] See id.

transactions are as common as intra-jurisdictional transactions in the security-based swap market.[43]

Second, dealers and other market participants are highly interconnected within this global market. While most market participants have only a few counterparties, dealers can have hundreds of counterparties, consisting of both non-dealing market participants (e.g., non-dealers, including commercial and financial market participants and investment funds) and other dealers.[44] Furthermore, as described in more detail below, the great majority of trades are dealer-to-dealer, rather than dealer-to-non-dealer or non-dealer-to-non-dealer, and a large fraction of single-name CDS volume is between counterparties domiciled in different jurisdictions. This interconnectedness facilitates the use of security-based swaps as a tool for sharing financial and commercial risks. In an environment in which market participants can have diverse and offsetting risk exposures, security-based swap transactions can allow participants to transfer risks so that they are borne by those who can do so efficiently. The global scale of the security-based swap market allows counterparties to access liquidity across jurisdictional boundaries, providing U.S. market participants with opportunities to share these risks with counterparties around the

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43 We note, however, that, in addition to classifying transactions between a U.S. counterparty and a foreign branch of a U.S. bank as cross-border transactions, see note 40, supra, these statistics characterize as cross-border transactions some transactions in which all or substantially all of the activity takes place in the United States and all or much of the risk of the transactions ultimately is borne by U.S. persons. That is, a transaction is classified as cross-border if the legal domicile of at least one of the counterparties to the transaction is outside the United States, but if the transaction is classified as cross-border solely on the basis of legal domicile, the risk associated with these transactions may still ultimately be borne by U.S. persons. In this sense, our estimates of the cross-border allocation of security-based swap activity may not precisely reflect the proportion of transactions that are cross-border in nature.

44 Based on an analysis of 2012 transaction data by staff in the Division of Economic and Risk Analysis, accounts associated with market participants recognized by ISDA as dealers had on average 403 counterparties. All other accounts (i.e., those more likely to belong to non-dealers) averaged four counterparties.

world. As discussed further in section VIII, a broad set of counterparties across which risks can be shared may result in more efficient risk sharing.

However, these opportunities for international risk sharing also represent channels for risk transmission. In other words, the interconnectedness of security-based swap market participants provides paths for liquidity and risk to flow throughout the system, so that it can be difficult to isolate risks to a particular entity or geographic segment. Because dealers facilitate the great majority of security-based swap transactions, with bilateral relationships that extend to potentially hundreds of counterparties, liquidity problems or other forms of financial distress that begin in one entity or one corner of the globe can potentially spread throughout the network, with dealers as a central conduit.

Third, as highlighted in the Intermediary Definitions Adopting Release, dealing activity within the market for security-based swaps is highly concentrated.[45] This concentration in large part appears to reflect the fact that larger entities possess competitive advantages in engaging in OTC security-based swap dealing activities, particularly with regard to having sufficient financial resources to provide potential counterparties with adequate assurances of financial performance.

The security-based swap market developed as an OTC market, without centralized trading venues or dissemination of pre- or post-trade pricing and volume information. In markets without transparent pricing, access to information confers a competitive advantage. In the current security-based swap market, large dealers and other large market participants with a large share of order flow have an informational advantage over smaller dealers and non-dealers who, in the absence of pre-trade transparency, observe a smaller subset of the market. Greater

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45 See Intermediary Definitions Adopting Release, 77 FR at 30639-42.

private information about order flow enables better assessment of current market values by dealers, permitting them to extract economic rents from counterparties who are less informed.[46] Non-dealers are aware of this information asymmetry, and certain non-dealers – particularly larger entities who transact with many dealers – may be able to obtain access to competitive pricing or otherwise demand a price discount that reflects the information asymmetry. Typically, however, the value of private information (i.e., the economic rent or informational premium) will be earned by those who have the most information. In the case of security-based swap markets, it is predominantly dealers who observe the greatest order flow and benefit from market opacity.

Taken together, the need for financial resources and the private information conveyed by order flow suggest that new entrants who intend to engage in security-based swap dealing activity in fact face high barriers to entry. One consequence of the current concentrated market structure is the potential for risk spillovers and contagion, which can occur when the financial sector as a whole (or certain key segments) becomes undercapitalized.[47] Unlike most other securities transactions, a security-based swap gives rise to ongoing obligations between transaction counterparties during the life of the transaction. This means that each counterparty to the transaction undertakes the obligation to perform the security-based swap in accordance with its terms and bears counterparty credit risk and market risk until the transaction expires or is

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46 In this situation, economic rents are the profits that dealers earn by trading with counterparties who are less informed. In a market with competitive access to information, there is no informational premium; dealers only earn a liquidity premium. The difference between the competitive liquidity premium and the actual profits that dealers earn is the economic rent.

47 See Viral V. Acharya, Lasse H. Pedersen, Thomas Philippon, and Matthew Richardson, "Measuring Systemic Risk" (May 2010), available at: http://vlab.stern.nyu.edu/public/static/SR-v3.pdf. The authors use a theoretical model of the banking sector to show that, unless the external costs of their trades are considered, financial institutions will have an incentive to take risks that are borne by the aggregate financial sector. Under this theory, in the context of Title VII, the relevant external cost is the potential for risk spillovers and sequential counterparty failure, leading to an aggregate capital shortfall and breakdown of financial intermediation in the financial sector.

terminated.[48] Within this interconnected market, participants may have ongoing bilateral obligations with multiple counterparties, allowing for efficient risk-sharing and access to liquidity throughout the global network. However, a primary risk of the integrated market is the potential for sequential counterparty failure and contagion when one or more large market participants become financially distressed, causing the market participant to default on its obligations to its counterparties.[49] A default by one or more security-based swap dealers or major security-based swap participants, or even the perceived lack of creditworthiness of these large entities, could produce contagion, either through direct defaults and risk spillovers, reduced willingness to extend credit, reduced liquidity, or reduced valuations for financial instruments. As financial distress spreads, the aggregate financial system may become undercapitalized, hindering its ability to provide financial intermediation services, including security-based swap intermediation services.

In other words, the failure of a single large firm active in the security-based swap market can have consequences beyond the firm itself. One firm's default may reduce the willingness of dealers to trade with, or extend credit to, both non-dealers and other dealers. By reducing the availability of sufficient credit to provide intermediation services, and by reducing transaction volume that reveals information about underlying asset values, the effects of a dealer default may, through asset price and liquidity channels, spill over into other jurisdictions and even other markets in which security-based swap dealers participate.

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[48] See Intermediary Definitions Adopting Release, 77 FR at 30616-17 (noting that "the completion of a purchase or sale transaction" in the secondary equity or debt markets "can be expected to terminate the mutual obligations of the parties," unlike security-based swap transactions, which often give rise to "an ongoing obligation to exchange cash flows over the life of the agreement").

[49] See Brunnermeier, Markus K., Andrew Crockett, Charles A. Goodhart, Avinash Persaud, and Hyun Song Shin. "The Fundamental Principles of Financial Regulation." (2009) at 15, available at: www.princeton.edu/~markus/research/papers/Geneva11.pdf.

Given that firms may be expected to consider the implications of security-based swap activity only on their own operations, without considering aggregate financial sector risk,[50] the financial system may end up bearing more risk than the aggregate capital of the intermediaries in the system can support and may cease to function normally during times of market distress. For example, during times of financial distress a dealer's leverage constraints may begin to bind, either because lenders require more collateral or because market declines erode a dealer's capital position, forcing the dealer to de-lever, either by selling assets or raising additional capital. Without adequate capital, the dealer may be unable to intermediate trades, potentially reducing liquidity in the markets it serves. Security-based swap positions replicate leveraged positions in the underlying asset, with a small amount of capital supporting large notional exposures.[51] Given the leveraged nature of swap transactions, and the concentrated structure of the dealer market, in which a large amount of highly leveraged risk exposures may be concentrated in a relatively small number of entities that are responsible for the vast majority of global dealing activity,[52] the potential consequences arising from financial instability in the security-based swap market may be acute.

In sum, the security-based swap market is characterized by a high level of interconnectedness, facilitating risk sharing by counterparties. Further, it is a global market, in

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50 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.

51 See Giulio Girardi, Craig Lewis, and Mila Getmansky, "Interconnectedness in the CDS Market," Division of Economic and Risk Analysis White Paper, April 2014, available at http://www.sec.gov/servlet/sec/dera/staff-papers/white-papers/credit-defaul-swaps-interconnectivity-04-2014.pdf (describing institutional features of credit default swaps).

52 The Commission estimates that, of approximately 1,000 transacting agents that participated in single-name CDS transactions in 2012, nearly 80 percent of transactions, by notional volume, can be attributed to the 13 largest entities. See also section III.A.2, infra.

which the potential for significant inter-jurisdictional activity and access to liquidity may enhance risk sharing among counterparties. At the same time, channels for risk sharing also represent channels for risk transmission. The global nature of this market, combined with the interconnectedness of market participants, means that liquidity shortfalls or risks that begin pooling in one corner of the market can potentially spread beyond that corner to the entire security-based swap market, with dealers as a key conduit. Because dealers and major participants are a large subset of all participants in the global security-based swap market and facilitate the majority of transactions (and thus reach many counterparties), concerns surrounding these types of spillovers are part of the framework in which we analyze the economic effects of our final rules implementing the security-based swap dealer and major participant definitions in the cross-border context.[53]

2. Context for Regulatory Determinations

In determining how Title VII requirements should apply to persons and transactions in a market characterized by the types of risks we have described, we are aware of the potentially significant tradeoffs inherent in our policy decisions. Our primary economic considerations for promulgating rules and guidance regarding the application of the security-based swap dealer and major participant definitions to cross-border activities include the effect of our choices on efficiency, competition, and capital formation,[54] the potential risks of security-based swaps to

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[53] We have previously noted that, depending on the size of the security-based swap dealer, default by a security-based swap dealer "could have adverse spillover or contagion effects that could create instability for the financial markets more generally." See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70214, 70304 (Nov. 23, 2012) ("Capital and Margin Proposing Release").

[54] See Exchange Act section 3(f).

U.S. market participants that could affect financial stability,[55] the level of transparency and counterparty protection in the security-based swap market, and the costs to market participants.[56]

As noted above, participants may use security-based swaps to manage financial and commercial risks and benefit from a liquid market with broad participation that facilitates risk sharing. We also recognize the possibility that the same channels that enable risk sharing also facilitate the transmission of risks and liquidity problems that begin pooling in one geographic segment of the market to the global security-based swap market. As described more fully in section III.A.1, U.S. entities may take on risk exposures in the security-based swap market by transacting with non-U.S. counterparties through non-U.S. affiliates. This suggests that an approach that applied these Title VII definitions to transactions only where all activity occurs inside the United States would have little effect in addressing the risks associated with security-based swaps, including risks and associated economic consequences flowing from contagion that may originate abroad and reach U.S. market participants through security-based swap activities and the multiple bilateral relationships that may form as a result of those activities. The global reach of security-based swap dealers, including U.S. dealers, participating in the vast majority of

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55 Title VII imposes financial responsibility and risk mitigation requirements on registered security-based swap dealers and major security-based swap participants. As we noted in proposing rules regarding capital and margin requirements applicable to security-based swap dealers, "the capital and margin requirements in particular are broadly intended to work in tandem to strengthen the financial system by reducing the potential for default to an acceptable level and limiting the amount of leverage that can be employed by [security-based swap dealers] and other market participants." See Capital and Margin Proposing Release, 77 FR at 70304. We also noted that "[r]equiring particular firms to hold more capital or exchange more margin may reduce the risk of default by one or more market participants and reduce the amount of leverage employed in the system generally, which in turn may have a number of important benefits." Id.

56 As we noted in the Cross-Border Proposing Release, the Commission generally understands the "U.S. financial system" to include the U.S. banking system and the U.S. financial markets, including the U.S. security-based swap market, the traditional securities markets (e.g., the debt and equity markets), and the markets for other financial activities (e.g., lending). See Cross-Border Proposing Release, 78 FR at 30980 n.97.

trades[57] and extending to upwards of hundreds of counterparties,[58] provides paths for these risks to flow back into the United States.[59]

At the same time, the Commission recognizes that the regulatory requirements we adopt for security-based swap dealers and major participants under Title VII may not reach all market participants that act as dealers or that have positions that pose considerable risk concerns in the global security-based swap markets. These limits to the application of Title VII raise several issues. First, market participants may shift their behavior. Final Title VII requirements may impose significant direct costs on participants falling within the security-based swap dealer and major security-based swap participant definitions that are not borne by other market participants, including costs related to capital and margin requirements, regulatory reporting requirements, and business conduct requirements. The costs of these requirements may provide economic incentive for some market participants falling within the dealer and major participant definitions to restructure their security-based swap business to seek to operate wholly outside of the Title VII regulatory framework by exiting the security-based swap market in the United States and not transacting with U.S. persons, potentially fragmenting liquidity across geographic boundaries.[60]

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57 See note 139, infra, and accompanying text.

58 See note 44, supra.

59 As discussed above, the global security-based swaps network, characterized by multiple bilateral relationships between counterparties, has the potential for risk spillovers and sequential counterparty failure. These exposures are not unique to the U.S. financial system. Indeed, the global scope of the security-based swap market suggests that, given our territorial approach to Title VII, there will be the fewest potential gaps in coverage if other jurisdictions also adopt similar comprehensive and comparable derivative regulations. See Section III.B for a discussion of global regulatory efforts in this space.

60 To the extent that registered dealers are ultimately subject to more extensive reporting and public dissemination requirements than other market participants under Title VII, these requirements may also alter the incentives of market participants to transact with registered dealers if, for example, public dissemination requirements reveal information that participants wish to treat as confidential about trading strategies or future hedging needs. Incentives for these participants to

Conversely, such incentives potentially may be mitigated by the fact that capital and margin requirements, counterparty protections, and business conduct standards required by Title VII[61] may promote financial stability and lead to non-dealer market participants exhibiting a preference for transacting with registered dealers and major participants.

Second, to the extent that other jurisdictions may adopt requirements with different scopes or on different timelines, the requirements we adopt may also result in competitive distortions. That is, differences in regulatory requirements across jurisdictions, or the ability of certain non-U.S. market participants to avoid security-based swap dealer regulation under Title VII, may generate competitive burdens and provide incentives for non-U.S. persons to avoid transacting with U.S. persons.

Third, key elements of the rules adopted today – the definition of "U.S. person," as well as rules covering treatment of guaranteed transactions, transactions with foreign branches, transactions conducted through conduit affiliates, and cleared anonymous transactions, and rules covering aggregation standards – all have implications for how U.S. and non-U.S. entities perform their de minimis and major participant threshold calculations and may affect the number of participants who ultimately register as security-based swap dealers or major security-based swap participants. The number of persons required to register will affect the costs and benefits of the substantive Title VII requirements that will ultimately be adopted; depending on the final rules, more or fewer entities, and therefore more or fewer security-based swaps, will be subject to Title VII requirements applicable to security-based swap dealers and major security-based

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avoid registered dealers could potentially isolate liquidity to less transparent corners of the market.

61 See, e.g., Exchange Act sections 15F(e), (f), (h) (providing that security-based swap dealers and major security-based swap participants be subject to requirements relating to capital and margin, reporting and recordkeeping, and business conduct).

swap participants.[62] Title VII requires the Commission to create a new regulatory regime that includes capital, margin, registration and reporting requirements aimed at increasing transparency and customer protections as well as mitigating the risk of financial contagion. Each of these requirements will impose new costs and regulatory burdens on persons that engage in security-based swap dealing activity at levels above the de minimis thresholds and on persons whose security-based swap positions are large enough to cause them to be major security-based swap participants.

We expect that these requirements' application to security-based swap dealers and major security-based swap participants subject to Title VII will be associated with a number of benefits to the security-based swap market and security-based swap market participants, including transparency, accountability, and increased counterparty protections.[63] Nevertheless, as we discuss later in this release, the de minimis rules for non-U.S. persons could allow certain non-U.S. entities to avoid the costs of dealer registration, which could reduce the number of entities that register as security-based swap dealers, relative to the Commission's estimates in the Intermediary Definitions Adopting Release. Although the number of entities that are not required to register will depend on the availability of the de minimis exclusions, we believe that, to the extent that the final rules change the number of eventual registrants, the ultimate

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62 Any forward-looking analysis of the costs and benefits that flow from these Title VII requirements necessarily encompasses uncertain elements, since the final requirements have not been adopted. For example, whether foreign security-based swap dealers will be subject to the full range of Title VII requirements in all of their transactions will be determined in subsequent rulemaking.

63 Title VII imposes a number of business conduct requirements designed to protect counterparties to security-based swaps, including disclosures about material risks and conflicts of interest, disclosures concerning the daily mark, or value of the position, and segregation of customer assets and collateral from the dealer's assets.

programmatic costs and benefits expected from Title VII may differ from those that were described in the Intermediary Definitions Adopting Release.[64]

Finally, the final rules determining how non-U.S. persons must perform their de minimis and major participant threshold calculations may face limits as to how precisely they address the risk mitigation goals of Title VII that are reflected in our rules implementing the de minimis exception and the "major security-based swap participant" definition. On the one hand, the scope of dealer and major participant regulation under Title VII may be subject to limitations on the ability to control risk because the global nature of counterparty interconnections means that it is difficult to prevent risk that pools in one geographic segment of the market from flowing throughout the entire security-based swap network. On the other hand, there is a possibility that the rules defining the scope of dealer and major participant regulation, including the territorial application of the definitions, may capture certain activity that does not represent risk to the U.S. financial system. Because these rules and guidance implementing Title VII regulatory definitions will not capture all transactions and all entities that engage in security-based swap activity, these rules and guidance therefore may create incentives for those entities at the boundaries of the definitions to restructure their business in a way that allows them to operate outside the scope of Title VII. However, as we described in the Intermediary Definitions Adopting Release, we have sought to implement the statutory dealer and major participant definitions in such a way as to impose the substantive rules of Title VII on those entities most

[64] See section IV.I.1 for a discussion of how we expect the cross-border application of the de minimis exception to alter the number of entities required to register with the Commission, and how that may affect the programmatic costs and benefits of Title VII.

likely to contribute to those risks that Title VII is intended to address without imposing unnecessary burdens on those who do not pose comparable risks to the U.S. financial system.[65]

B. Scope of Title VII's Application to Cross-Border Security-Based Swap Activity

Congress has given the Commission authority in Title VII to implement a security-based swap regulatory framework to address the potential effects of security-based swap activity on U.S. market participants, the financial stability of the United States, on the transparency of the U.S. financial system, and on the protection of counterparties.[66] The global nature of the security-based swap market and the high proportion of cross-border transactions in that market[67] mean that much of this activity occurs at least in part outside the United States and frequently involves persons that are incorporated, organized, or established in a location outside the United

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65 In adopting the definition of "security-based swap dealer," we intended to determine the set of entities in the security-based swap market for whom regulation "is warranted due to the nature of their interactions with counterparties, or is warranted to promote market stability and transparency." See Intermediary Definitions Adopting Release, 77 FR at 30726. Similarly, in adopting rules governing the "major security-based swap participant" definition, we sought to impose regulations applicable to major security-based swap participants in a way that reflects "when it would be 'prudent' that particular entities be subject to monitoring, management and oversight of entities that may be systemically important or may significantly impact the U.S. financial system." See id. at 30666.

Future rulemakings that depend on these definitions are intended to address the transparency, risk, and customer protection goals of Title VII. For example, to further risk mitigation in the security-based swap market, we explained that "section 15F(e) of the Exchange Act and related rules impose capital and margin requirements on dealers and major participants, which will reduce the financial risks of these institutions and contribute to the stability of the security-based swap market in particular and the U.S. financial system more generally." See id. at 30723.

66 See note 11, supra. See also Pub. L. No. 111-203 sections 701-774 (providing for, among other things, a comprehensive new regulatory framework for security-based swaps, including by: (i) providing for the registration and comprehensive regulation of security-based swap dealers and major security-based swap participants; (ii) imposing clearing and trade execution requirements on security-based swaps, subject to certain exceptions; and (iii) creating real-time reporting and public dissemination regimes for security-based swaps).

67 See section II.A, supra (noting that cross-border activity accounts for the majority of security-based swaps involving U.S. firms).

States.[68] In light of these market realities, we noted in the proposal that applying Title VII only to persons incorporated, organized, or established within the United States or only to security-based swap activity occurring entirely within the United States would inappropriately exclude from regulation a majority of security-based swap activity that involves U.S. persons or otherwise involves conduct within the United States, even though such activity raises the types of concerns that we believe Congress intended to address through Title VII.[69]

Because some commenters had, prior to the proposal, argued that section 30(c) of the Exchange Act limited our ability to reach certain types of activity occurring at least in part outside the United States,[70] we discussed in some detail in the proposal our preliminary views on the appropriate approach to determining whether certain security-based swap activity that involves some conduct outside the United States also occurs within the United States for purposes of Title VII.[71] In this subsection, we discuss comments received on this question following publication of our proposal and explain our final views – which remain largely unchanged from the proposal – on the proper approach to determining whether cross-border security-based swap activity occurs, in relevant part, within the United States.[72] We then briefly

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68 For example, a single financial firm engaged in dealing activity may utilize two or more entities domiciled in different countries to effectuate a single transaction with a counterparty that may similarly use multiple entities domiciled in different countries.

69 See Cross-Border Proposing Release, 78 FR at 30984.

70 See id. at 30983. Exchange Act section 30(c) was added to the Act by Title VII and provides, among other things, that "[n]o provision of [Title VII] . . . shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States," unless that business is transacted in contravention of rules prescribed to prevent evasion of Title VII. See section 30(c) of the Exchange Act, 15 U.S.C. 78dd(c), added by section 772(b) of the Dodd-Frank Act.

71 See Cross-Border Proposing Release, 78 FR at 30984-87.

72 We also interpret what it means for a person to "transact a business in security-based swaps without the jurisdiction of the United States" as set forth in Exchange Act section 30(c). 15 U.S.C. 78dd(c).

describe how this framework applies to specific types of transactions relevant to the rules we are adopting here.[73]

1. Commenters' Views

Prior to our proposal, several commenters raised concerns about the application of Title VII to security-based swap activity in the cross-border context and specifically about the possibility that we would impose Title VII requirements on "extraterritorial" conduct. We received only a few comments on this issue in response to our preliminary views set forth in the proposal, and these generally focused on the application of section 30(c) of the Exchange Act to specific types of activity that we proposed to subject to Title VII rather than the proposed territorial framework more broadly.

One commenter expressed general agreement with our proposed guidance.[74] Three commenters suggested that textual differences between section 30(c) of the Exchange Act and section 2(i) of the Commodity Exchange Act ("CEA") do not require the Commission to take a different approach to application of Title VII to cross-border security-based swap activity from that taken by the CFTC.[75] Two commenters expressed the view that section 30(c) of the

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73 The following discussion does not reflect a comprehensive analysis of the full range of transactions that may fall within our territorial approach to application of Title VII or of the full range of substantive requirements to which such transactions may be subject under Title VII.

It is important to note that our approach to the application of Title VII security-based swap dealer and major security-based swap participant registration requirements does not limit, alter, or address the cross-border reach or extraterritorial application of any other provisions of the federal securities laws, including Commission rules, regulations, interpretations, or guidance.

74 See BM Letter at 6.

75 See IIB Letter at 4 (noting, inter alia, that section 712 of the Dodd-Frank Act requires consultation and coordination between the SEC, CFTC, and prudential regulators, and arguing that differences between Exchange Act section 30(c) and CEA section 2(i) do not require the Commission to take an approach to regulation of cross-border security-based swap activity that is "fundamentally different" from that taken by the CFTC); SIFMA/FIA/FSR Letter at A-4 to A-5 (stating that Exchange Act section 30(c) must be read to harmonize with CFTC approach in light of congressional intent that rules be harmonized); FOA Letter at 7 (referring to this element of the

Exchange Act, considered in light of what they described as the risk-based focus of Title VII, prohibited the Commission from imposing Title VII requirements on transactions carried out within the United States but booked in locations outside the United States.[76] One commenter stated that section 30(c) of the Exchange Act prevents us from imposing Title VII requirements on transactions of guaranteed foreign affiliates of U.S. persons.[77] One commenter argued that section 30(c) prevents application of Title VII to certain joint ventures.[78]

2. Scope of Application of Title VII in the Cross-Border Context

We continue to believe that a territorial approach to the application of Title VII is appropriate. This approach, properly understood, is grounded in the text of the relevant statutory provisions and is designed to help ensure that our application of the relevant provisions is

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SIFMA/FIA/FSR Letter). Section 2(i) of the CEA provides, inter alia, that Title VII requirements will not apply to activities outside the United States unless they "have a direct and significant connection with activities in, or effect on, commerce of the United States." 7 U.S.C. 2(i). The CFTC Cross-Border Guidance was adopted as an interpretation of this provision. See CFTC Cross-Border Guidance, 78 FR at 45295.

76 See SIFMA/FIA/FSR Letter at 4, A-4 to A-6 (acknowledging that proposed application of Title VII to transactions conducted within the United States between two non-U.S. persons is consistent with Commission practice in traditional securities markets but arguing that similar language in sections 30(b) and 30(c) of the Exchange Act should be read differently, given the different nature of security-based swap transactions and focus of Title VII on risk); FOA Letter at 7 (referring to this element of the SIFMA/FIA/FSR Letter). These commenters argue that we should focus on risks to the U.S. financial system and the protection of U.S. counterparties, and that neither concern is raised by transactions between two non-U.S. persons that happen to occur within the United States. See SIFMA/FIA/FSR Letter at A-5 to A-6. We continue to believe that this argument does not account for the full range of concerns addressed by Title VII, but, as discussed further below, we are not addressing issues surrounding the proposed "transaction conducted within the United States" definition in this release.

Because, as discussed above, we are not adopting "transaction conducted within the United States" as part of the final rule, we anticipate considering these comments in connection with soliciting additional public comment.

77 See id. at A-11 (stating that a guarantee may not necessarily import risk into the United States and thus creates "no nexus for purposes of [s]ection 30(c) of the Exchange Act").

78 See Mitsubishi UFJ Financial Group ("MUFJ") Letter at 4-5 (urging the Commission not to require both participants in a foreign joint venture to aggregate the dealing transactions of the joint venture for purposes of the dealer de minimis calculation).

consistent with the goals that the statute was intended to achieve.

(a) Overview and General Approach

As in our proposal, our analysis begins with an examination of the text of the statutory provision that imposes the relevant requirement. The statutory language generally identifies the types of conduct that trigger the relevant requirement and, by extension, the focus of the statute.[79] Once we have identified the activity regulated by the statutory provision, we can determine whether a person is engaged in conduct that the statutory provision regulates and whether this conduct occurs within the United States. When the statutory text does not describe the relevant activity with specificity or provides for further Commission interpretation of statutory terms or requirements, this analysis may require us to identify through interpretation of the statutory text the specific activity that is relevant under the statute or to incorporate prior interpretations of the relevant statutory text.[80]

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79 See Morrison v. National Australia Bank, Ltd., 130 S. Ct. 2869, 2884 (2010) (identifying focus of statutory language to determine what conduct was relevant in determining whether the statute was being applied to domestic conduct).

Section 772(b) of the Dodd-Frank Act amends section 30 of the Exchange Act to provide that "[n]o provision of [Title VII] . . . shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States," unless that business is transacted in contravention of rules prescribed to prevent evasion of Title VII. See section 30(c) of the Exchange Act. As noted above, some commenters suggest that statutory language requiring us to coordinate and consult with the CFTC also requires us to interpret section 30(c) of the Exchange Act in a manner similar to the CFTC's interpretation of CEA section 2(i). See note 75, supra. However, in light of the differences between Exchange Act section 30(c) and CEA section 2(i), we do not find this argument persuasive. As noted above, however, in developing final rules we have carefully considered the CFTC's guidance and the underlying policy rationales, consistent with the statutory requirement that we consult and coordinate with the CFTC.

80 The Dodd-Frank Act provides that the CFTC and SEC "shall further define" several terms, including "security-based swap dealer" and "major security-based swap participant." Dodd-Frank Act section 712(d) (emphasis added). The Commissions fulfilled this mandate in the Intermediary Definitions Adopting Release. See Intermediary Definitions Adopting Release, 77 FR at 30973.

As noted above, the Dodd-Frank Act was enacted, in part, with the intent to address the risks to the financial stability of the United States posed by entities engaged in security-based swap activity, to promote transparency in the U.S. financial system, and to protect counterparties to such transactions.[81] These purposes, considered together with the specific statutory requirement, lead us to conclude that it is appropriate to impose the statutory requirements, and rules or regulations thereunder, on security-based swap activity occurring within the United States even if certain conduct in connection with the security-based swap also occurs in part outside the United States.

Contrary to the views expressed by some commenters,[82] we do not agree that the location of risk alone should necessarily determine the scope of an appropriate territorial application of every Title VII requirement, given that the definition and the relevant regulatory regime address not only risk but other concerns as well, as just described. For example, neither the statutory definition of "security-based swap dealer," our subsequent further definition of the term pursuant to section 712(d) of the Dodd-Frank Act, nor the regulatory requirements applicable to security-based swap dealers focus solely on risk to the U.S. financial system.[83]

We believe that this approach to territorial application of Title VII provides a reasonable means of helping to ensure that our regulatory framework focuses on security-based swap activity that is most likely to raise the concerns that Congress intended to address in Title VII,

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81 See e.g., note 11, supra. See also Exchange Act section 15F(h) (establishing business conduct standards for security-based swap dealers and major security-based swap participants).

82 See notes 76-77, supra.

83 See note 88, infra, and accompanying text (describing elements of statutory definition of "security-based swap dealer"); note 90, infra, and accompanying text (describing elements of the further definition of "security-based swap dealer" adopted by the Commission and the CFTC pursuant to section 712(d) of the Dodd-Frank Act); Exchange Act section 15F(h) (establishing business conduct standards for security-based swap dealers).

including the potential effects of security-based swap activity on U.S. market participants, on the financial stability of the United States, on the transparency of the U.S. financial markets, and on the protection of counterparties.[84] Persons that engage in relevant conduct, as identified through this analysis, within the United States are not, in our view, "transact[ing] a business in security-based swaps without the jurisdiction of the United States,"[85] and thus are properly subject to regulation under Title VII.

(b) Territorial Approach to Application of Title VII Security-Based Swap Dealer Registration Requirements

In determining whether specific transactions should be included in a person's dealer de minimis calculation, we begin by looking to the statutory text to identify the type of dealing activity that the statute describes as relevant to a person's status as a security-based swap dealer.[86] Section 3(a)(71) of the Exchange Act[87] defines security-based swap dealer as a person that engages in any of the following types of activity:

(i) holding oneself out as a dealer in security-based swaps,

(ii) making a market in security-based swaps,

(iii) regularly entering into security-based swaps with counterparties as an ordinary course of business for one's own account, or

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84 See note 11, supra.

85 Exchange Act section 30(c).

86 See Intermediary Definitions Adopting Release, 77 FR at 30616-30619 (further defining "security-based swap dealer" by identifying the types of activities that characterize dealing and that would therefore lead a transaction to be required to be included in a person's de minimis calculation under Exchange Act rule 3a71-2).

87 15 U.S.C. 78c(a)(71).

(iv) engaging in any activity causing oneself to be commonly known in the trade as a dealer in security-based swaps.[88]

In accordance with the authority provided by section 712(d)(1) of the Dodd-Frank Act, which provides that the CFTC and the Commission shall by rule further define, among other things, "security-based swap dealer,"[89] we further interpreted the statutory definition by identifying the types of activities that are relevant in determining whether a person is a security-based swap dealer.[90] Pursuant to this further definition, indicia of security-based swap dealing activity include any of the following activities:

- providing liquidity to market professionals or other persons in connection with security-based swaps;
- seeking to profit by providing liquidity in connection with security-based swaps,
- providing advice in connection with security-based swaps or structuring security-based swaps;
- having a regular clientele and actively soliciting clients;
- using inter-dealer brokers; and
- acting as a market maker on an organized security-based swap exchange or trading system.[91]

As the foregoing lists illustrate, both the statutory text and our interpretation further defining the statutory term include within the security-based swap dealer definition a range of activities. In the Intermediary Definitions Adopting Release, we stated that transactions arising

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88 Exchange Act section 3(a)(71)(A), 15 U.S.C. 78c(a)(71)(A).

89 See Dodd-Frank Act section 712(d)(1).

90 See Intermediary Definitions Adopting Release, 77 FR at 30617-18.

91 Id.

from dealing activity, as identified by the indicia described above, would generally be subject to relevant Title VII requirements applicable to dealers, including that such transactions be included in a person's calculations for purposes of the dealer de minimis calculations. Our territorial approach applying Title VII to dealing activity similarly looks to whether any of the activities described above occur within the United States, and not simply to the location of the risk, as some commenters suggested is required under section 30(c) of the Exchange Act.[92] To the extent that such activity does occur within the United States, the person engaged in such activity, in our view, is transacting a business in security-based swaps within the United States,[93] and therefore applying Title VII to the activity by, among other things, requiring the person to include transactions arising from such activity in its de minimis calculation is consistent with a territorial approach, even if some of this activity (or other activity bearing the indicia of dealing activity) relating to the transaction also occurs outside the United States.

This approach is consistent with the purposes of the dealer definition and the de minimis exception as they relate to dealer regulation under Title VII. The de minimis exception excludes from the dealer registration requirement those entities that may engage in dealing activity but that do so in amounts that may not raise, to a degree that warrants application of security-based swap dealer requirements, the risk, counterparty protection, or other concerns that the dealer registration and regulatory framework were intended to address.[94] On the other hand, dealing activity, as identified by the types of activities described above, carried out within the United

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92 See notes 76-77, supra.

93 Cf. Exchange Act section 30(c) (limiting the application of, among other provisions, Title VII to "any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States").

94 See, e.g., Intermediary Definitions Adopting Release, 77 FR at 30629-30 (noting that the de minimis threshold is intended to capture firms that engage in a level of dealing activity that is likely to raise the types of concerns that the dealer regulatory framework is intended to address).

States at levels exceeding the de minimis threshold is likely to raise these concerns, which would be addressed by requiring persons engaged in that volume of dealing activity to register as security-based swap dealers under Title VII and to comply with relevant requirements applicable to security-based swap dealers. Accordingly, to the extent that a person engages in dealing activity within the United States that results in transactions in a notional amount exceeding the applicable de minimis threshold, it is appropriate to require the person to register as a security-based swap dealer.

i. Dealing Activity of U.S. Persons

Under the foregoing analysis and consistent with our proposal, when a U.S. person as defined under this final rule[95] engages in dealing activity, it necessarily engages in such activity within the United States, even when it enters into such transactions through a foreign branch or office. As discussed in further detail below, the definition of "U.S. person" in the final rule is intended, in part, to identify those persons for whom it is reasonable to infer that a significant portion of their financial and legal relationships are likely to exist within the United States and that it is therefore reasonable to conclude that risk arising from their security-based swap activities could manifest itself within the United States, regardless of the location of their counterparties, given the ongoing nature of the obligations that result from security-based swap transactions.[96]

Wherever a U.S. person enters into a transaction in a dealing capacity, it is the U.S. person as a whole that is holding itself out as a dealer in security-based swaps, given that the

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[95] See Exchange Act rule 3a71-3(a)(4).

[96] See section IV.C, infra. In our view, dealing activity involving such persons is particularly likely to raise the types of concerns Title VII was intended to address, including those related to risk to the U.S. financial system, transparency of the U.S. financial markets, and customer protection.

financial resources of the entire person stand behind any dealing activity of the U.S. person, both at the time it enters into the transaction and for the life of the contract, even when the U.S. person enters into the transaction through a foreign branch or office. Moreover, the U.S. person as a whole seeks to profit by providing liquidity and engaging in market-making in security-based swaps, and the financial resources of the entire person enable it to provide liquidity and engage in market-making in connection with security-based swaps. Its dealing counterparties will look to the entire U.S. person, even when the U.S. person enters into the transaction through a foreign branch or office, for performance on the transaction. The entire U.S. person assumes, and stands behind, the obligations arising from the resulting agreement and is directly exposed to liability arising from non-performance of the non-U.S. person.[97]

For these reasons, in our view a person does not hold itself out as a security-based swap dealer as anything other than a single person even when it enters into transactions through its foreign branch or office.[98] Because the foreign branch generally could not operate as a dealer absent the financial and other resources of the entire U.S. person, its dealing activity with all of its counterparties, including dealing activity conducted through its foreign branch or office, is best characterized as occurring, at least in part, within the United States and should therefore be included in the person's de minimis threshold calculation.[99]

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97 Cf. SIFMA/FIA/FSR Letter at 4, A-5 (stating that main purpose of Title VII is to address risk arising from security-based swap activity).

98 This is consistent with the view expressed in our proposing release. See Cross-Border Proposing Release, 78 FR at 30985.

99 As discussed in further detail below, this interpretation is consistent with the goals of dealer regulation under Title VII. Security-based swap activity that results in a transaction involving a U.S.-person counterparty creates ongoing obligations that are borne by a U.S. person and, as such, is properly viewed as occurring within the United States. See note 186, infra.

ii. Dealing Transactions of Non-U.S. Persons that are Subject to Recourse Guarantees by their U.S. Affiliates

In the proposing release, we explained that we preliminarily believed that a territorial approach consistent with the text and purposes of the Dodd-Frank Act encompasses transactions involving a non-U.S. person counterparty whose dealing activity is guaranteed by a U.S. person.[100] However, because we proposed to treat non-U.S. persons receiving a guarantee on their security-based swap transactions from a U.S. person like any other non-U.S. person for purposes of the de minimis exception (i.e., requiring them to include in their calculations only dealing activity involving U.S.-person counterparties or transactions conducted within the United States), we did not elaborate specifically on how the presence of a guarantee related to a territorial application of the dealer definition, including the de minimis exception. Because our final rule requires transactions of non-U.S. persons whose obligations under the security-based swap are subject to recourse guarantees enforceable against their U.S. affiliates to be included in the dealer de minimis calculation of the non-U.S. person, we address it here.

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[100] In our proposal, we noted that in a security-based swap transaction between two non-U.S. persons where the performance of at least one side of the transaction is guaranteed by a U.S. person, the guarantee gives the guaranteed person's counterparty recourse to the U.S. person for performance of obligations owed by the guaranteed person under the security-based swap, and the U.S. guarantor exposes itself to the risk of the security-based swap as if it were a counterparty to the security-based swap through the security-based swap activity engaged in by the guaranteed person. See Cross-Border Proposing Release, 78 FR at 30986-87. This interpretation of guarantee was consistent with our discussion of the application of the major participant tests to guaranteed positions in the Intermediary Definitions Adopting Release, where we, together with the CFTC, noted that a person's security-based swap positions are attributed to a parent, other affiliate, or guarantor for purposes of the major participant analysis to the extent that the counterparties to those positions have recourse to that parent, other affiliate, or guarantor in connection with the position; as we noted in that release, positions are not attributed in the absence of recourse. See Intermediary Definitions Adopting Release, 77 FR at 30689. In this release, we continue to use the term "guarantee" to refer to an arrangement pursuant to which one party to a security-based swap transaction has recourse to its counterparty's parent, other affiliate, or guarantor with respect to the counterparty's obligations owed under the transaction. See section IV.E.1(b), infra.

In our view, a non-U.S. person engaged in dealing activity, to the extent that one or more transactions arising from such activity are guaranteed by a U.S. person, is engaged in relevant activity for purposes of the security-based swap dealer definition within the United States, with respect to those transactions. By virtue of the guarantee, the non-U.S. person effectively acts together with the U.S. person to engage in the dealing activity that results in the transactions, and the non-U.S. person's dealing activity with respect to such transactions cannot reasonably be isolated from the U.S. person's activity in providing the guarantee. The U.S.-person guarantor together with the non-U.S. person whose dealing activity it guarantees, and not just the non-U.S. person, may seek to profit by providing liquidity and engaging in market-making in security-based swaps, and the non-U.S. person provides liquidity and engages in market-making in connection with security-based swaps by drawing on the U.S. person's financial resources.[101] The non-U.S. person's counterparty, pursuant to the recourse guarantee, looks to both the non-U.S. person and its U.S. guarantor, which is responsible for performance on the transaction that is part of the non-U.S. person's dealing activity. In sum, the non-U.S. person is engaged in the United States in relevant dealing activity identified in the statutory definition and in our jointly adopted further definition of "security-based swap dealer."

[101] Even if the U.S. guarantor generally does not hold itself out as a dealer or make a market in security-based swaps, the U.S. guarantor enables the non-U.S. person whose dealing activity it guarantees to engage in dealing activity by providing financial backing. We note that references to "guarantee," "recourse guarantee," or "rights of recourse," as those terms are used in this release, may describe economic relationships that are different from "guarantee" under section 2(a)(1) of the Securities Act. We note, however, that, depending on the nature of the "guarantee," "recourse guarantee," or "rights of recourse" provided by the guarantor, the transaction at issue may involve not only a security-based swap between two non-U.S. persons but also the offer and sale of a security by a U.S. person, given that a "guarantee" of a security-based swap is itself a separate security issued by the U.S. guarantor. See, e.g., Securities Act section 2(a)(1), 15 U.S.C. 77b(a)(1) (including in the statutory definition of "security" a guarantee of a security).

Moreover, the economic reality of the non-U.S. person's dealing activity, where the resulting transactions are guaranteed by a U.S. person, is identical, in relevant respects, to a transaction entered into directly by the U.S. guarantor. By virtue of the guarantee, transactions arising from the non-U.S. person's dealing activity result in risk from the transaction being borne by a U.S. person (the guarantor, which is responsible for the transactions it guarantees in a manner similar to a direct counterparty to the transactions) and potentially the U.S. financial system in a manner similar to a dealing transaction entered into directly by a U.S. person. As with transactions entered into directly by a U.S. person, transactions for which a counterparty has a right of recourse against a U.S. person create risk to a U.S. person and potentially the U.S. financial system regardless of the location of the counterparty.

Our interpretation of the statutory text of the definition, as well as our further definition of the term, as it applies to these entities is consistent with the purposes of Title VII, as discussed above. The exposure of the U.S. guarantor creates risk to U.S. persons and potentially to the U.S. financial system via the guarantor to a comparable degree as if the transaction were entered into directly by a U.S. person. We understand that in some circumstances a counterparty may choose not to enter into a security-based swap transaction (or may not do so on the same terms) with a non-U.S. subsidiary of a U.S. person when that non-U.S. subsidiary is acting in a dealing capacity to the extent that its dealing activity is not subject to a recourse guarantee by a U.S. affiliate, absent other circumstances (e.g., adequate capitalization of the hitherto-guaranteed affiliate).

One commenter noted that U.S. guarantors may provide guarantees for a variety of reasons, including to satisfy regulatory requirements, to "manage capital treatment across an entity," and to "avoid negative credit rating consequences," and argued that a guarantee may

therefore not create risk within the United States.[102] Absent the creation of such risk, this commenter further argued that a guarantee creates "no nexus for purposes of section 30(c) of the Exchange Act."[103] However, regardless of the motivation for providing the guarantee, the non-U.S. person's dealing activity still occurs within the United States and creates risk within the United States in the manner described above. The commenter provided no evidence that the motivation for providing a guarantee affects this analysis: It neither alters the risk created within the United States by such a guarantee when it is provided by a U.S. person nor affects the economic reality of the transaction. Moreover, even if a person provides guarantees not in response to counterparty demands but to satisfy regulatory requirements or to avoid negative credit rating consequences, the very reasons for issuing the guarantee suggest that the non-U.S. person would not be able to engage in dealing activity, or to do so on the same terms, without the guarantee.[104]

In sum, the guarantee provided by a U.S. person poses risk to U.S. persons and potentially to the U.S. financial system, and both the non-U.S. person whose dealing activity is

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[102] SIFMA/FIA/FSR Letter at A-11.

[103] Id.

[104] In addition, this commenter suggested that any risk created by guarantees provided to prudentially regulated foreign entities is adequately addressed by the foreign prudential regulation. See id. Although we recognize that foreign prudential regulation may reduce the risk that a guaranteed foreign affiliate's counterparties will seek to enforce the terms of the guarantee against the U.S. guarantor (depending on the quality of prudential regulation in the foreign jurisdiction), it does not eliminate this risk, and the counterparty continues to retain a right of recourse under the guarantee against the guarantor.

Given the role of a foreign person whose activity is guaranteed in creating risk within the United States through its dealing activity, we believe that it is important to ensure that such a foreign person be required to register as a security-based swap dealer to the extent that its guaranteed dealing transactions (together with any dealing transactions with U.S. persons) are included in its de minimis threshold calculations. As noted above, our proposal set forth a framework under which substituted compliance potentially would be available for certain Title VII requirements, including for dealer-specific requirements such as capital and margin, which should mitigate concerns about overlapping regulation of such entities.

guaranteed and its counterparty rely on the creditworthiness of the U.S. guarantor when entering into a security-based swap transaction and for the duration of the security-based swap. The economic reality of this transaction, even though entered into by a non-U.S. person, is substantially identical, in relevant respects, to a transaction entered into directly by a U.S. person. Accordingly, in our view, it is consistent with both the statutory text and with the purposes of the statute to identify such transactions as occurring within the United States for purposes of Title VII.

iii. Dealing Activity of Other Non-U.S. Persons

In our proposal, we stated that non-U.S. persons engaging in dealing activity would be required to count toward their de minimis thresholds only transactions arising from their dealing activity with U.S. persons or dealing activity otherwise conducted within the United States. Under the approach described above, and consistent with our proposal, we believe that a non-U.S. person engaged in dealing activity with U.S. persons engages in relevant activity for purposes of the security-based swap dealer definition within the United States.[105]

Dealing activity of non-U.S. persons that involves counterparties who are U.S. persons, as that term is defined in the final rule, necessarily involves the performance by the non-U.S. person of relevant activity under the "security-based swap dealer" definition at least in part within the United States. For example, in our view, a non-U.S. person engaging in dealing activity with a U.S. person is holding itself out as a dealer in security-based swaps within the

105 We continue to believe that security-based swap activity carried out within the United States may also be relevant activity under our territorial approach, even if the resulting transaction involves two non-U.S. counterparties. As discussed below, however, we anticipate soliciting additional public comment regarding the issue.

United States.[106] Similarly, by entering into a transaction with a U.S. person in a dealing capacity, it is seeking to profit by providing liquidity within the United States and possibly engaging in market-making in security-based swaps within the United States, given that its decision to engage in dealing activity with U.S. persons, as defined by the rule, affects the liquidity of the security-based swap market within the United States. Particularly at volumes in excess of the de minimis threshold, entering into security-based swap transactions in a dealing capacity with U.S. persons likely is the type of activity that would cause a non-U.S. person "to be commonly known in the trade as a dealer in security-based swaps"[107] within the United States, that constitutes "regularly entering into security-based swaps with counterparties as an ordinary course of business for one's own account"[108] within the United States, and that permits a reasonable inference that it has a regular clientele and actively solicits clients within the United States.[109]

Our application of the statute to non-U.S. persons is consistent with the purposes of Title VII, as discussed above. U.S. persons incur risks arising from this dealing activity, which in turn potentially creates risk to other market participants and the U.S. financial system more generally, and transactions with U.S. persons raise counterparty protection and market transparency concerns that Title VII is intended to address. Accordingly, we believe that the dealing activity

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106 Given the global nature of the security-based swap market, U.S. persons seeking to access this market may readily do so through both U.S.-person dealers and foreign dealers. That a foreign dealer holding itself out as a dealer to U.S. persons is based in, and operating out of, a foreign jurisdiction does not alter the economic reality of its activity: It is holding itself out as a dealer within the United States in a manner largely indistinguishable from a U.S.-person dealer that "hangs out its shingle" in Manhattan.

107 Exchange Act section 3(a)(71)(A)(iv).

108 Exchange Act section 3(a)(71)(A)(iii).

109 See Intermediary Definitions Adopting Release, 77 FR at 30618.

of a non-U.S. person that involves a U.S.-person counterparty is appropriately characterized as occurring, at least in part, within the United States.[110]

(c) Territorial Approach to Application of Title VII Major Security-Based Swap Participant Registration Requirements

As in our territorial approach to the security-based swap dealer definition (including the de minimis exception) described above, our territorial approach to the application of the major security-based swap participant definition looks first to the statutory text to identify the types of activity that are relevant for purposes of the definition. Section 3(a)(67) of the Exchange Act provides that a major security-based swap participant is any person who is not a dealer and who satisfies one or more of the following requirements:

(i) maintains a substantial position in security-based swaps for any of the major security-based swap categories,[111] excluding certain positions;

(ii) has outstanding security-based swaps that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or

(iii) is a highly leveraged financial entity that maintains substantial position in outstanding security-based swaps in any major security-based swap category.[112]

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110 Although at least one commenter suggested that we lack the authority under section 30(c) of the Exchange Act to require non-U.S. person joint-ventures to aggregate relevant dealing transactions with the relevant dealing transactions of multiple investors in the joint-venture, see note 78, supra, we believe that our limitation on application of the aggregation requirement only to the transactions of such non-U.S. persons that occur within the United States (because they involve U.S.-person counterparties or are subject to a recourse guarantee against a U.S. person) is consistent with our territorial approach.

111 The statute further provides the Commission with the authority to determine the scope of these categories. See Exchange Act section 3(a)(67)(A)(ii)(I).

112 Exchange Act section 3(a)(67)(A).

The statute directs us to further define, jointly with the CFTC, "major security-based swap participant"[113] and separately provides us with authority to "define . . . the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States."[114]

Pursuant to these provisions, we further interpreted this definition by, among other things, defining what constitutes a "substantial position" and "substantial counterparty exposure" for purposes of the major security-based swap participant definition.[115] In doing so, we set forth calculation methodologies and thresholds for each and adopted rules requiring persons that exceeded these thresholds to register as major security-based swap participants.[116] These thresholds were designed to identify persons that were likely to pose counterparty credit risks, as such risks are "more closely linked to the statutory criteria that the definition focuses on entities that are 'systemically important' or can 'significantly impact' the U.S. financial system."[117] We also noted that our definition of "substantial position" was intended to address the risk that would be posed by the default of multiple entities close in time and the aggregate risks presented by a person's security-based swap activity, as these considerations reflect the market risk concerns expressly identified in the statute.[118]

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113 Dodd-Frank Act section 712(d)(1).

114 Exchange Act section 3(a)(67)(B).

115 See Intermediary Definitions Adopting Release, 77 FR at 30663-84.

116 See id.

117 Id. at 30666.

118 See id. We defined "substantial counterparty exposure" in a similar manner, noting the focus of the statutory test on "serious adverse effects on financial stability or financial markets." Id. at 30683. Cf. Section 3(a)(67)(A)(ii)(II) of the Exchange Act (encompassing in major security-based swap participant definition persons whose "outstanding security-based swaps create

The statutory focus of the major security-based swap participant definition differs from that of security-based swap dealer, in that the security-based swap dealer definition focuses on activity that may raise the concerns that dealer regulation is intended to address, while the major security-based swap participant definition focuses on positions that may raise systemic risk concerns within the United States. Accordingly, a territorial approach to application of the definition of major security-based swap participant involves identifying security-based swap positions that exist within the United States.[119] In our view, and consistent with the approach taken in our proposal, a security-based swap position exists within the United States when it is held by or with a U.S. person, or when it is subject to a recourse guarantee against a U.S. person,[120] as the risks associated with such positions are borne within the United States, and given the involvement of U.S. persons may, at the thresholds established for the major security-based swap participant definition, give rise to the types of systemic risk within the United States that major security-based swap regulation is intended to address. To the extent that a position exists within the United States in this sense, we believe that it is appropriate under a territorial approach to require a market participant, whether a U.S. person or otherwise, that is a counterparty or guarantor with respect to that position, to include that position in its major security-based swap participant threshold calculations, wherever the security-based swap was entered into.

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substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets").

119 Cf. Morrison, 130 S. Ct. at 2884 (performing a textual analysis to identify the focus of the statute).

120 The economic reality of a position subject to such a guarantee, even though entered into by a non-U.S. person, is substantially identical in relevant respects to a position entered into directly by the U.S. guarantor. See section II.B.2(b)ii, supra.

(d) Regulations Necessary or Appropriate to Prevent Evasion of Title VII

Consistent with our proposal, we interpret section 30(c) of the Exchange Act as not requiring us to find that actual evasion has occurred or is occurring to invoke our authority to reach activity "without the jurisdiction of the United States" or to limit application of Title VII to security-based swap activity "without the jurisdiction of the United States" only to business that is transacted in a way that is purposefully intended to evade Title VII. Section 30(c) of the Exchange Act authorizes the Commission to apply Title VII to persons transacting a business "without the jurisdiction of the United States" if they contravene rules that the Commission has prescribed as "necessary or appropriate to prevent the evasion of any provision" of Title VII. The focus of this provision is not whether such rules impose Title VII requirements only on entities engaged in evasive activity but whether the rules are generally "necessary or appropriate" to prevent potential evasion of Title VII. In other words, section 30(c) of the Exchange Act permits us to impose prophylactic rules intended to prevent possible purposeful evasion, even though such rules may affect or prohibit some non-evasive conduct. Moreover, exercising the section 30(c) authority does not require us to draw a distinction between conduct "without the jurisdiction of the United States" that is purposely evasive as opposed to identical conduct that was motivated by some non-evasive purpose. Indeed, to interpret section 30(c) authority otherwise could create a bifurcated regulatory regime where the same conduct is treated differently based on parties' underlying purpose for engaging in it, which could create extraordinary oversight challenges involving difficult subjective considerations concerning parties' true intentions in entering any given transaction or establishing particular business

structures, and could create significant competitive advantages for incumbent firms.[121] Thus, we read the statute to permit us to prescribe such rules to conduct without the jurisdiction of the United States, even if those rules would also apply to a market participant that has been transacting business through a pre-existing market structure, such as a foreign branch or foreign affiliate whose positions are guaranteed by the market participant, established for valid business purposes, provided the proposed rule or guidance is designed to prevent possibly evasive conduct.[122]

C. Principles Guiding Final Approach to Applying "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions in the Cross-Border Context

As in our proposal, our final rules and guidance reflect our careful consideration of the global nature of the security-based swap market and the types of risks created by security-based swap activity to the U.S. financial system and market participants and other concerns that the dealer and major security-based swap participant definitions were intended to address, as well as the needs of a well-functioning security-based swap market.[123] We also have been guided by the purpose of Title VII[124] and the applicable requirements of the Exchange Act, including the following:

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121 Such an interpretation of our anti-evasion authority, for example, could privilege incumbent firms by allowing them to leverage existing business models that may not be available to new entrants under rules promulgated pursuant to that authority.

122 As a general matter, the final rules adopted in this release are not being applied to persons who are "transacting a business in security-based swaps without the jurisdiction of the United States" within the meaning of section 30(c) of the Exchange Act. See sections II.B.2(a)-(c), supra. However, as noted below, the Commission also believes that these rules are necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act and thus help ensure that the particular purposes of the Dodd-Frank Act addressed by the rule are not undermined. See, e.g., section II.B.2(d) and note 186, infra.

123 See section II.A, supra.

124 See note 11, supra.

- Economic Impacts—The Exchange Act requires the Commission to consider the impact of our rulemakings on efficiency, competition, and capital formation.[125]
- Counterparty Protection—The Dodd-Frank Act adds provisions to the Exchange Act relating to counterparty protection, particularly with respect to "special entities."[126]
- Transparency—The Dodd-Frank Act was intended to promote transparency in the U.S. financial system.[127]
- Risk to the U.S. Financial System—The Dodd-Frank Act was intended to promote, among other things, the financial stability of the United States by limiting/mitigating risks to the financial system.[128]
- Anti-Evasion—The Dodd-Frank Act amends the Exchange Act to provide the Commission with authority to prescribe rules and regulations as necessary or appropriate to prevent the evasion of any provision of the Exchange Act that was added by the Dodd-Frank Act.[129]
- Consultation and Coordination with Other U.S. Regulators—In connection with implementation of Title VII, the Dodd Frank Act requires the Commission to consult

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125 Specifically, section 3(f) of the Exchange Act provides: "Whenever pursuant to this title the Commission is engaged in rulemaking, . . . , and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." Section 23(a)(2) of the Exchange Act also provides: "The Commission . . . , in making rules and regulations pursuant to any provisions of this title, shall consider among other matters the impact any such rule or regulation would have on competition. The Commission . . . shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]."

126 See Exchange Act section 15F(h), as added by section 764(a) of the Dodd-Frank Act, in particular.

127 See note 11, supra.

128 Id.

129 See Exchange Act section 30(c), 15 U.S.C. 78dd(c), as discussed in section II.B.2(d), supra.

and coordinate with the CFTC and prudential regulators for the purpose of ensuring "regulatory consistency and comparability, to the extent possible."[130]

- Consistent International Standards—To promote effective and consistent global regulation of swaps and security-based swaps, the Dodd-Frank Act requires the Commission and the CFTC to consult and coordinate with foreign regulatory authorities on the "establishment of consistent international standards" with respect to the regulation of swaps and security-based swaps.[131] In this regard, the Commission recognizes that regulators in other jurisdictions are currently engaged in implementing their own regulatory reforms of the OTC derivatives markets and that our application of Title VII to cross-border activities may affect the policy decisions of these other regulators as they seek to address potential conflicts or overlaps in the regulatory requirements that apply to market participants under their authority.[132]

At times, these principles reinforce one another; at other times, they may be in tension. For instance, regulating risk posed to the United States may, depending on the final rules, make it more costly for U.S.-based firms to conduct security-based swap business, particularly in foreign markets, compared to foreign firms; it could make foreign firms less willing to deal with U.S. persons; and it could discourage foreign firms from carrying out security-based swap dealing activity through branches or offices located in the United States. On the other hand, providing U.S. persons greater access to foreign security-based swap markets may, depending on the final rules, fail to appropriately address the risks posed to the United States from transactions

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130 See section 712(a)(2) of the Dodd-Frank Act.

131 See section 752(a) of the Dodd-Frank Act.

132 For example, subjecting non-U.S. persons to Title VII may prompt a foreign jurisdiction to respond by subjecting U.S. persons to the foreign jurisdiction's regulatory regime.

conducted in part outside the United States or create opportunities for market participants to evade the application of Title VII, particularly until such time as other jurisdictions adopt similar comprehensive and comparable derivative regulations.

Balancing these sometimes competing principles has been complicated by the fact that Title VII imposes a new regulatory regime in a global marketplace. Title VII establishes reforms that will have implications for entities that compete internationally in the global security-based swap market. We have generally sought, in accordance with the statutory factors described above, to avoid creating opportunities for market participants to evade Title VII requirements, whether by restructuring their business or other means, or the potential for overlapping or conflicting regulations. We also have considered the needs for a well-functioning security-based swap market and for avoiding disruption that may reduce liquidity, competition, efficiency, transparency, or stability in the security-based swap market.

III. Baseline

To assess the economic impact of the final rules described in this release, we are using as our baseline the security-based swap market as it exists at the time of this release, including applicable rules we have already adopted but excluding rules that we have proposed but not yet finalized.[133] The analysis includes the statutory and regulatory provisions that currently govern the security-based swap market pursuant to the Dodd-Frank Act.[134] We acknowledge limitations in the degree to which we can quantitatively characterize the current state of the security-based

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133 We also consider, where appropriate, the impact of rules and technical standards promulgated by other regulators, such as the CFTC and the European Securities and Markets Authority, on practices in the security-based swap market.

134 As noted above, we have not yet adopted other substantive requirements of Title VII that may affect how firms structure their security-based swap business and market practices more generally.

swap market. As we describe in more detail below, because the available data on security-based swap transactions do not cover the entire market, we have developed an understanding of market activity using a sample that includes only certain portions of the market.

A. Current Security-Based Swap Market

Our analysis of the state of the current security-based swap market is based on data obtained from DTCC-TIW, especially data regarding the activity of market participants in the single-name CDS market during the period from 2008 to 2012. While other repositories may collect data on transactions in total return swaps on equity and debt, we do not currently have access to such data for these products (or other products that are security-based swaps). We have previously noted that the definition of security-based swaps is not limited to single-name CDS but we believe that the single-name CDS data are sufficiently representative of the market and therefore can directly inform the analysis of the state of the current security-based swap market.[135] Additionally, the data for index CDS encompass both broad-based security indices and narrow-based security indices, and "security-based swap" in relevant part encompasses

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135 According to data published by the Bank for International Settlements ("BIS"), the global notional amount outstanding in equity forwards and swaps as of June 2013 was $2.32 trillion. The notional amount outstanding in single-name CDS was approximately $13.14 trillion, in multi-name index CDS was approximately $10.17 trillion, and in multi-name, non-index CDS was approximately $1.04 trillion. See Semi-annual OTC derivatives statistics at end-June 2013 (Nov. 2013), Table 19, available at: http://www.bis.org/statistics/dt1920a.pdf. As we stated in the Cross-Border Proposing Release, for the purposes of this analysis, we assume that multi-name index CDS are not narrow-based index CDS and therefore, do not fall within the security-based swap definition. See Cross-Border Proposing Release, 78 FR at 31120 n.1301; see also Exchange Act section 3(a)(68)(A); Further Definition of "Swap," "Security-Based-Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453 (July 18, 2012), 77 FR 48208 (Aug. 13, 2012) ("Product Definitions Adopting Release"), 77 FR 48208. We also assume that all instruments reported as equity forwards and swaps are security-based swaps, potentially resulting in underestimation of the proportion of the security-based swap market represented by single-name CDS. Based on those assumptions, single-name CDS appear to constitute roughly 80 percent of the security-based swap market. No commenters disputed these assumptions, and we therefore continue to believe that, although the BIS data reflect the global OTC derivatives market, and not just the U.S. market, these ratios are an adequate representation of the U.S. market.

swaps based on single securities or reference entities or on narrow-based security indices. Accordingly, with the exception of the analysis regarding the degree of overlap between participation in the single-name CDS market and the index CDS market (cross-market activity), our analysis below does not include data regarding index CDS.

We believe that the data underlying our analysis here provide reasonably comprehensive information regarding the single-name CDS transactions and composition of the single-name CDS market participants. We note that the data available to us from DTCC-TIW do not encompass those CDS transactions that both: (i) do not involve U.S. counterparties;[136] and (ii) are based on non-U.S. reference entities. Notwithstanding this limitation, we believe that the DTCC-TIW data provide sufficient information to identify the types of market participants active in the security-based swap market and the general pattern of dealing within that market.[137]

1. Security-Based Swap Market Participants

A key characteristic of security-based swap activity is that it is concentrated among a relatively small number of entities that engage in dealing activities. In addition to these entities, thousands of other participants appear as counterparties to security-based swap contracts in our sample, and include, but are not limited to, investment companies, pension funds, private (hedge) funds, sovereign entities, and industrial companies. We observe that most non-dealer users of security-based swaps do not engage directly in the trading of swaps, but use dealers, banks, or

[136] We note that DTCC-TIW's entity domicile determinations may not reflect our definition of "U.S. person" in all cases.

[137] The challenges we face in estimating measures of current market activity stems, in part, from the absence of comprehensive reporting requirements for security-based swap market participants. The Commission has proposed rules regarding trade reporting, data elements, and real-time public reporting for security-based swaps that would provide us with appropriate measures of market activity. See Regulation SBSR - Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 34-63346 (Nov. 19, 2010), 75 FR 75208 (Dec. 2, 2010).

investment advisers as intermediaries or agents to establish their positions. Based on an analysis of the counterparties to trades reported to the DTCC-TIW, there are 1,695 entities that engaged directly in trading between November 2006 and December 2012.

Table 1, below, highlights that more than three-quarters of these entities (DTCC-defined "firms" shown in DTCC-TIW, which we refer to here as "transacting agents") were identified as investment advisers, of which approximately 40 percent (about 30 percent of all transacting agents) were registered investment advisers under the Investment Advisers Act of 1940 ("Investment Advisers Act").[138] Although investment advisers comprise the vast majority of transacting agents, the transactions they executed account for only 10.8 percent of all single-name CDS trading activity reported to the DTCC-TIW, measured by number of transaction-sides (each transaction has two transaction sides, i.e., two transaction counterparties). The vast majority of transactions (81.9 percent) measured by number of transaction-sides were executed by ISDA-recognized dealers.[139]

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[138] See 15 U.S.C. 80b1–80b21. Transacting agents participate directly in the security-based swap market, without relying on an intermediary, on behalf of principals. For example, a university endowment may hold a position in a security-based swap that is built up by an investment adviser that transacts on the endowment's behalf. In this case, the university endowment is a principal that uses the investment adviser as its transacting agent.

[139] The 1,695 entities included all DTCC-defined "firms" shown in DTCC-TIW as transaction counterparties that report at least one transaction to DTCC-TIW as of December 2012. The staff in the Division of Economic and Risk Analysis classified these firms, which are shown as transaction counterparties, by machine matching names to known third-party databases and by manual classification. This is consistent with the methodology used in the proposal. See Cross-Border Proposing Release, 78 FR at 31120 n.1304. Manual classification was based in part on searches of the EDGAR and Bloomberg databases, the SEC's Investment Adviser Public Disclosure database, and a firm's public website or the public website of the account represented by a firm. The staff also referred to ISDA protocol adherence letters available on the ISDA website.

Table 1. The number of transacting agents by counterparty type and the fraction of total trading activity, from November 2006 through December 2012, represented by each counterparty type.

Transacting Agents	Number	Percent	Transaction share
Investment Advisers	1,261	74.4%	10.9%
- SEC registered	*510*	*30.1%*	*6.6%*
Banks	256	15.1%	5.9%
Pension Funds	27	1.6%	0.1%
Insurance Companies	32	1.9%	0.3%
ISDA-Recognized Dealers[140]	17	1.0%	82.1%
Other	102	6.0%	0.8%
Total	1,695	100.0%	100.0%

Principal holders of CDS risk exposure are represented by "accounts" in the DTCC-TIW.[141] The staff's analysis of these accounts in DTCC-TIW shows that the 1,695 transacting agents classified in Table 1 represent over 9,238 principal risk holders. Table 2, below, classifies these principal risk holders by their counterparty type and whether they are represented by a registered or unregistered investment adviser.[142] For instance, 256 banks in Table 1 allocated transactions across 364 accounts, of which 25 were represented by investment advisers. In the remaining 339 instances, banks traded for their own accounts. Meanwhile, 17 ISDA-recognized dealers in Table 1 allocated transactions across 65 accounts.

140 For the purpose of this analysis, the ISDA-recognized dealers are those identified by ISDA as belonging to the G14 or G16 dealer group during the period: JP Morgan Chase NA (and Bear Stearns), Morgan Stanley, Bank of America NA (and Merrill Lynch), Goldman Sachs, Deutsche Bank AG, Barclays Capital, Citigroup, UBS, Credit Suisse AG, RBS Group, BNP Paribas, HSBC Bank, Lehman Brothers, Société Générale, Credit Agricole, Wells Fargo and Nomura. See, e.g., http://www.isda.org/c_and_a/pdf/ISDA-Operations-Survey-2010.pdf.

141 "Accounts" as defined in the DTCC-TIW context are not equivalent to "accounts" in the definition of "U.S. person" provided by Exchange Act rule 3a71-3(a)(4)(i)(C). They also do not necessarily represent separate legal persons. One entity or legal person may have multiple accounts. For example, a bank may have one DTCC account for its U.S. headquarters and one DTCC account for one of its foreign branches.

142 Unregistered investment advisers include all investment advisers not registered under the Investment Advisers Act and may include investment advisers registered with a state or a foreign authority.

Among the accounts, there are 1,000 Dodd-Frank Act-defined special entities and 570 investment companies registered under the Investment Company Act of 1940.[143] Private funds comprise the largest type of account holders that we were able to classify, and although not verified through a recognized database, most of the funds we were not able to classify appear to be private funds.[144]

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143 See 15 U.S.C. 80a1 through 80a64. There remain over 4,000 DTCC "accounts" unclassified by type. Although unclassified, each was manually reviewed to verify that it was not likely to be a special entity within the meaning of the Dodd-Frank Act and instead was likely to be an entity such as a corporation, an insurance company, or a bank.

144 Private funds for this purposes encompasses various unregistered pooled investment vehicles, including hedge funds, private equity funds, and venture capital funds.

Table 2. The number and percentage of account holders—by type—who participate in the security-based swap market through a registered investment adviser, an unregistered investment adviser, or directly as a transacting agent, from November 2006 through December 2012.

Account Holders by Type	Number	Represented by a registered investment adviser		Represented by an unregistered investment adviser		Participant is transacting agent[145]	
Private Funds	2,696	1,275	47%	1,400	52%	21	1%
DFA Special Entities	1,000	973	97%	7	1%	20	2%
Registered Investment Companies	570	560	98%	8	1%	2	0%
Banks (non-ISDA-recognized dealers)	364	21	6%	4	1%	339	93%
Insurance Companies	205	132	64%	20	10%	53	26%
ISDA-Recognized Dealers	65	0	0%	0	0%	65	100%
Foreign Sovereigns	57	40	70%	2	4%	15	26%
Non-Financial Corporations	55	37	67%	3	5%	15	27%
Finance Companies	8	4	50%	0	0%	4	50%
Other/Unclassified	4,218	2,885	68%	1,146	27%	187	4%
All	9,238	5,927	64%	2,590	28%	721	8%

(a) Dealing Structures

Security-based swap dealers use a variety of business models and legal structures to engage in dealing business with counterparties in jurisdictions all around the world. As we noted in the proposal, both U.S.-based and foreign-based entities use certain dealing structures for a variety of legal, tax, strategic, and business reasons.[146] Dealers may use a variety of structures in

145 This column reflects the number of participants who are also trading for their own accounts.

146 See Cross-Border Proposing Release, 78 FR at 30976-78.

part to reduce risk and enhance credit protection based on the particular characteristics of each entity's business.

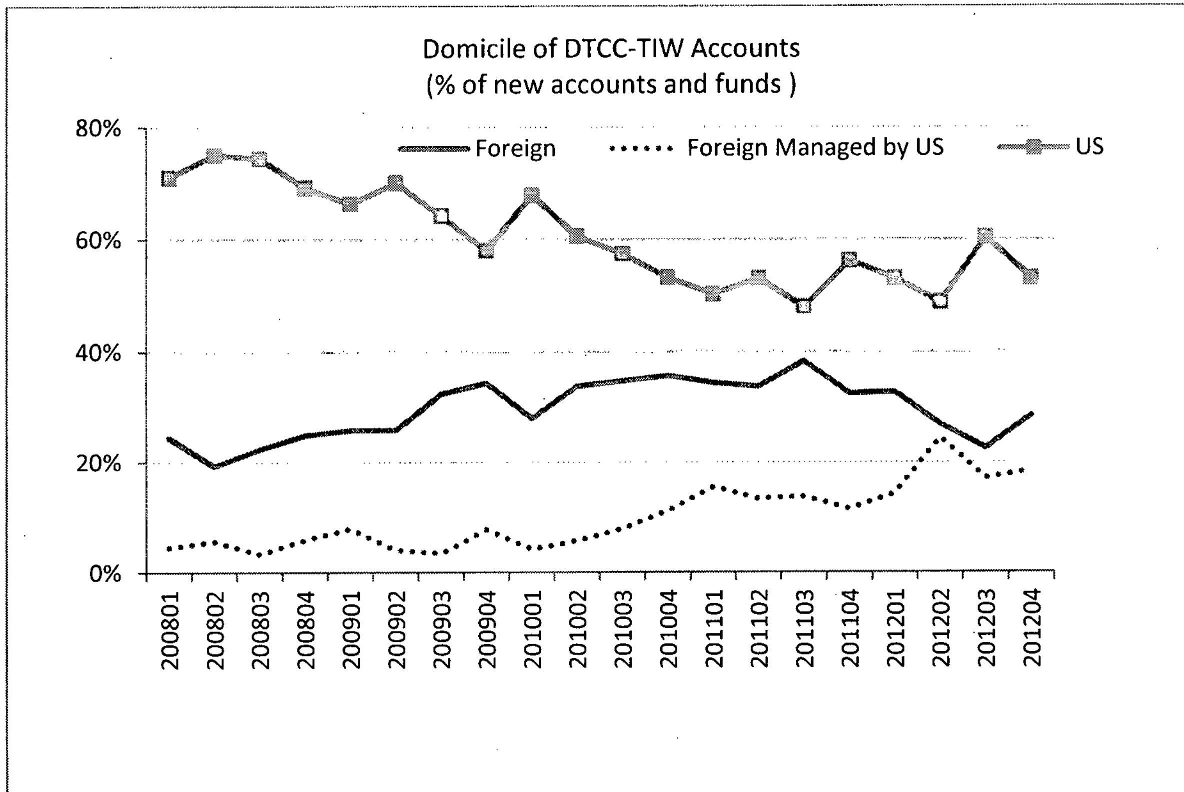
Bank and non-bank holding companies may use subsidiaries to deal with counterparties. Further, dealers may rely on multiple sales forces to originate security-based swap transactions. For example, a U.S. bank dealer may use a sales force in its U.S. home office to originate security-based swap transactions in the United States and use separate sales forces spread across foreign branches to originate security-based swap transactions with counterparties in foreign markets.

In some situations, an entity's performance under security-based swaps may be supported by a guarantee provided by an affiliate. More generally, guarantees may take the form of a blanket guarantee of an affiliate's performance on all security-based swap contracts, or a guarantee may apply only to a specified transaction or counterparty. Guarantees may give counterparties to the dealer direct recourse to the holding company or another affiliate for its dealer-affiliate's obligations under security-based swaps for which that dealer-affiliate acts as counterparty.

(b) Participant Domiciles

The security-based swap market is global in scope, with counterparties located across multiple jurisdictions. As depicted in Figure 1, the domicile of new accounts participating in the market has shifted over time.

Figure 1: The percentage of (1) new accounts with a domicile in the United States (referred to as "US"), (2) new accounts with domicile outside the United States (referred to below as "Foreign"), and (3) new accounts outside the United States but managed by a U.S. entity, account of a foreign branch of a U.S. bank, and account of a foreign subsidiary of a U.S. entity (collectively referred to below as "Foreign Managed by US").[147] Unique, new accounts are aggregated each quarter and shares are computed on a quarterly basis, from January 2008 through December 2012.



Over time a greater share of accounts entering the market either have a foreign domicile, or have a foreign domicile while being managed by a U.S. person. The increase in foreign accounts may reflect an increase in participation by foreign accountholders while the increase in foreign accounts managed by U.S. persons may reflect the flexibility with which market participants can restructure their market participation in response to regulatory intervention, competitive pressures, and other stimuli. There are, however, alternative explanations for the

147 In these instances, the fund or account lists a non-U.S. registered office location while the investment adviser, U.S. bank, or U.S. parent lists the United States as its settlement country.

shifts in new account domicile we observe in Figure 1. Changes in the domicile of new accounts through time may reflect improvements in reporting by market participants to DTCC-TIW.[148] Additionally, because the data only include accounts that are domiciled in the United States, transact with U.S.-domiciled counterparties, or transact in single-name CDS with U.S. reference entities, changes in the domicile of new accounts may reflect increased transaction activity between U.S. and non-U.S. counterparties.

A U.S.-based holding company may conduct dealing activity through a foreign subsidiary that faces both U.S. and foreign counterparties. Similarly, foreign dealers may choose to deal with U.S. and foreign counterparties through U.S. subsidiaries. Non-dealer users of security-based swaps may participate in the market using an agent in their home country or abroad. An investment adviser located in one jurisdiction may transact in security-based swaps on behalf of beneficial owners that reside in another.

The various layers separating origination from booking by dealers, and management from ownership by non-dealer users, highlights the potential distinctions between the location where a transaction is arranged, negotiated, or executed, the location where economic decisions are made by managers on behalf of beneficial owners, and the jurisdiction ultimately bearing the financial risks associated with the security-based swap transaction that results. As a corollary, a participant in the security-based swap market may be exposed to counterparty risk from a jurisdiction that is different from the market center in which it participates.

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148 Consistent with the guidance on CDS data access, see text accompanying note 37, supra, DTCC-TIW surveyed market participants, asking for the physical address associated with each of their accounts (i.e., where the account is incorporated as a legal entity). This is designated the registered office location. For purposes of this discussion, we have assumed that the registered office location reflects the place of domicile for the fund or account. When the fund does not report a registered office location, we assume that the settlement country reported by the investment adviser or parent entity to the fund or account is the place of domicile.

(c) Current Estimates of Dealers and Major Participants.

In the Intermediary Definitions Adopting Release, we estimated, based on an analysis of DTCC-TIW data, that out of more than 1,000 entities engaged in single-name CDS activity worldwide in 2011, 166 entities engaged in single-name CDS activity at a sufficiently high level that they would be expected to incur assessment costs to determine whether they meet the "security-based swap dealer" definition.[149] Analysis of those data further indicated that potentially 50 entities may engage in dealing activity that would exceed the de minimis threshold and thus ultimately have to register as security-based swap dealers.[150]

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149 Based on the de minimis threshold of $3 billion for single-name CDS, we estimated that there were 123 entities engaged in engaged in single-name CDS transactions in 2011 that had more than $3 billion in single-name CDS transactions over the previous 12 months. We also estimated that 43 entities with between $2 and $3 billion in transactions over the trailing 12 months may opt to engage in the dealer analysis out of an abundance of caution or to meet internal compliance guidelines, thus leading to the 166 total. See Intermediary Definitions Adopting Release, 77 FR at 30731-32; see also Cross-Border Proposing Release, 78 FR at 31139-40. We adopted a phase-in period during which the de minimis threshold will be $8 billion and during which Commission staff will study the security-based swap market as it evolves under the new regulatory framework, resulting in a report that will consider the operation of the security-based swap dealer and major security-based swap participant definitions. At the end of the phase-in period, the Commission will take into account the report, as well as public comment on the report, in determining whether to terminate the phase-in period or propose any changes to the rule implementing the de minimis exception, including any increases or decreases to the $3 billion threshold. See Intermediary Definitions Adopting Release, 77 FR at 30640.

150 In particular, we estimated that 28 entities and corporate groups had three or more counterparties that are not ISDA dealers (which we viewed as a useful proxy for application of the dealer-trader distinction) and that 25 of those entities had trailing notional transactions exceeding $3 billion. See id. at 30725 n.1457; SEC Staff Report, "Information regarding activities and positions of participants in the single-name credit default swap market ("CDS Data Analysis") (Mar. 15, 2012), available at: http://www.sec.gov/comments/s7-39-10/s73910-154.pdf at 14. Our additional estimate of up to 50 potential dealers reflected our recognition of the potential for growth in the security-based swap market, for new entrants into the dealing space, and the possibility that some corporate groups may register more than one entity. See Intermediary Definitions Adopting Release, 77 FR at 30725 n.1457.

In the Cross-Border Proposing Release, we revised those estimates to reflect a more granular analysis of the data. Under this refined approach – which identified the number of entities within a corporate group that may have to register – we estimated that 46 individual firms had three or more non-ISDA dealer counterparties, and that, of those, 31 firms engaged in at least $3 billion of security-based swap activity in 2011. We further estimated that, under the cross-border

Analysis of more recent data regarding the single-name CDS market using the same methodology suggests comparable results that are consistent with the reduction in transaction volume noted below. In particular, single-name CDS data from 2012 indicate that out of more than 1,000 entities engaged in single-name CDS activity, approximately 145 engaged in single-name CDS activity at a level high enough such that they may be expected to perform the dealer-trader analysis prescribed under the security-based swap dealer definition.[151] These data suggest that, consistent with the Intermediary Definitions Adopting Release analysis, up to approximately 50 entities would engage in dealing activity that would exceed the de minimis threshold.[152]

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provisions of proposed Exchange Act rule 3a71-3(b), 27 of those entities engaged in at least $3 billion notional activity that they would have to count against the de minimis threshold, and that accounting for the aggregation requirement may result in an additional two firms being required to register, for a total of 29. We also concluded that our original estimate of there being up to 50 dealers was still valid, noting that the revised estimate included individual entities within corporate groups (thus accounting for the possibility that some corporate groups may register more than one dealer), and also accounted for the likely results of the proposed aggregation requirement. See Cross-Border Proposing Release, 78 FR 31137-38 n.1407.

151 Consistent with the earlier analysis, this figure is derived from the fact that 110 transacting agents had total single-name security-based swap activity above the $3 billion de minimis threshold, while another 35 transacting agents had activity between $2 and $3 billion and hence out of caution may be expected to engage in the dealer-trader analysis.

In calculating this estimate, Commission staff used methods identical to those used referenced in the Intermediary Definitions Adopting Release, 77 FR at 30732 n.1509, aggregating the activity of DTCC accounts to the level of transacting agents and estimating the number of transacting agents with gross transaction notional amounts exceeding $2 billion in 2012. While the analysis contained in the Intermediary Definitions Adopting Release used a sample that ended in December 2011, the sample has been updated through the end of December 2012.

In connection with the economic analysis of the final cross-border dealer de minimis rules, we also have estimated the number of entities that may perform the dealer-trader analysis using a more granular methodology that considers data both at the account level and at the transacting agent level. See notes 456 through 458, infra, and accompanying text.

152 As discussed below, and consistent with the methodology used in the Cross-Border Proposing Release, 78 FR at 31137 n.1407, data from 2012 indicates that 40 entities engaged in the single-name security-based swap market had three or more counterparties that were not identified by ISDA as dealers, and that 27 of those entities had $3 billion or more in notional single-name CDS activity over a 12 month period. Applying the principles reflected in these final rules regarding

Additionally, in the Intermediary Definitions Adopting Release, we estimated, based on position data from DTCC-TIW for 2011, that as many as 12 entities would be likely to perform substantial position and substantial counterparty exposure tests, and thus incur assessment costs, prescribed under the major security-based swap participant definition. Of these 12 firms, we estimated that the number of persons with positions sufficiently large to bring them within the scope of the definition of major security-based swap participant likely would be fewer than five. Although we did not specify how the major security-based swap participant definition would apply to foreign persons in the Intermediary Definitions Adopting Release, our approach in estimating the assessment costs caused by our final definition used available single-name CDS data as a proxy for the market as a whole, and assumed that all potential major security-based swap participants would be required to include in their threshold calculations all positions with all counterparties.

Analysis of more recent data regarding the single-name CDS market suggests comparable results. In particular, single-name CDS data from 2012 indicate that out of over 1,100 DTCC-TIW firms holding positions in single-name CDS activity and not expected to register as

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the counting of transactions against the de minimis thresholds suggests that 25 of those entities would have $3 billion or more in notional transactions counted against the thresholds, and that applying the aggregation rules increases that number to 26 entities. Based on this data, we believe that it is reasonable to conclude that up to 50 entities ultimately may register as security-based swap dealers, although the number may be smaller. See note 444, infra.

In this regard it is important to note that, due to limitations in the availability of the underlying data, this analysis does not include information about transactions involving single-name CDS with a non-U.S. reference entity when neither party is domiciled in the United States or guaranteed by a person domiciled in the United States. This is because for single-name CDS with a non-U.S. reference entity, the data supplied to the Commission by the DTCC-TIW encompasses only information regarding transactions involving at least one counterparty domiciled in the United States or guaranteed by a person domiciled in the United States, based on physical addresses reported by market participants. That data exclusion introduces the possibility that these numbers may underestimate the number of persons that would engage in the dealer-trader analysis (and hence incur assessment costs) or that exceed $3 billion in dealing transactions on an annual basis (and hence would potentially be linked to programmatic costs and benefits).

security-based swap dealers, nine had worldwide single-name CDS positions at a level high enough such that they may be expected to perform the major security-based swap participant threshold analysis prescribed under the security-based swap dealer definition. Analysis based on these more recent data is consistent with the prior conclusion that five or fewer entities would be likely to register as major security-based swap participants.[153]

2. Levels of Security-Based Swap Trading Activity

Single-name CDS contracts make up the vast majority of security-based swap products and most are written on corporate issuers, corporate securities, sovereign countries, or sovereign debt (reference entities and reference securities). Figure 1 below describes the percentage of global, notional transaction volume in North American corporate single-name CDS reported to the DTCC-TIW between January 2008 and December 2012, separated by whether transactions are between two ISDA-recognized dealers (interdealer transactions) or whether a transaction has at least one non-dealer counterparty.

The level of trading activity with respect to North American corporate single-name CDS in terms of notional volume has declined from more than $5 trillion in 2008 to approximately $2 trillion in 2012.[154] While notional volume has declined over the past five years, the share of

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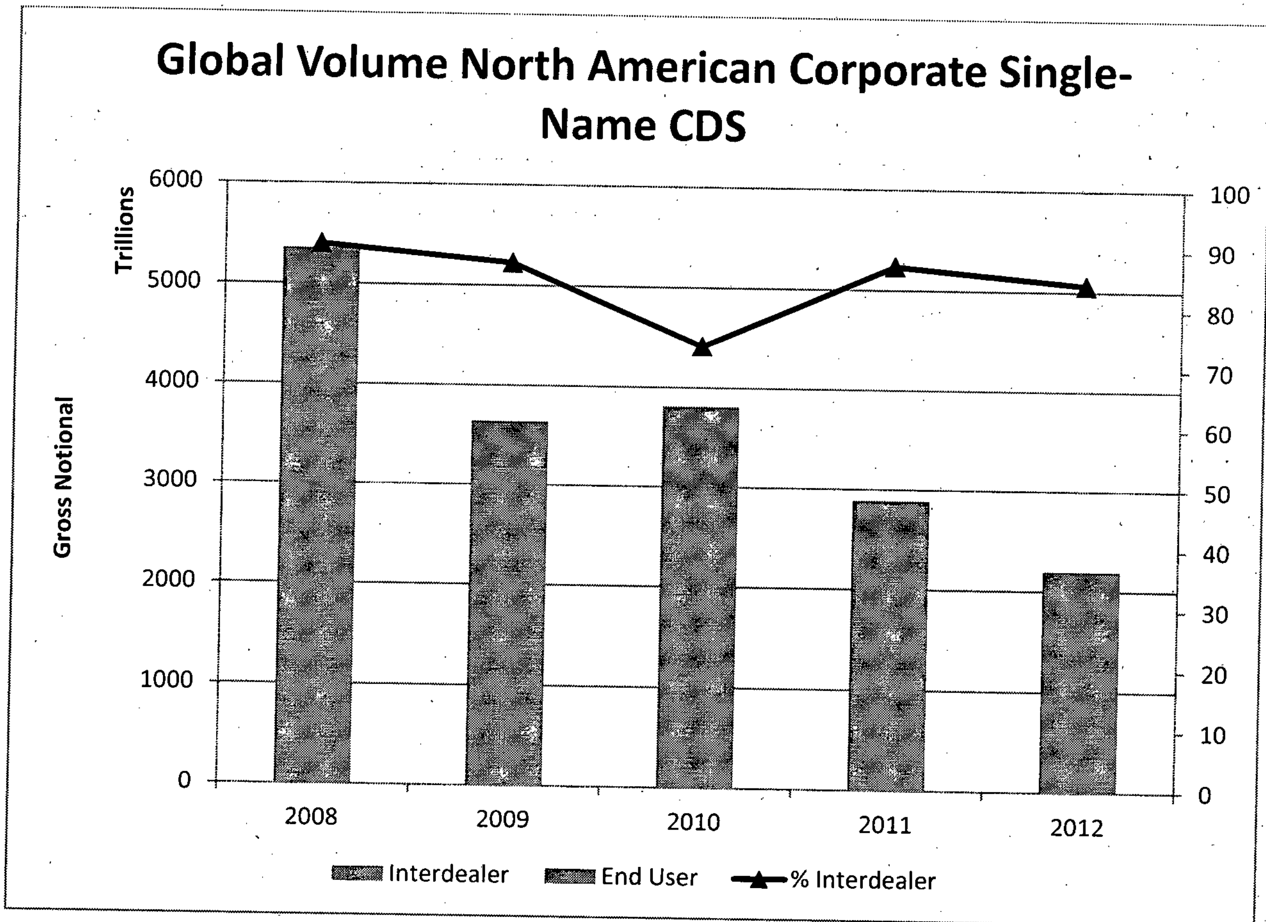
153 In calculating this estimate, Commission staff used methods identical to those used referenced in the Intermediary Definitions Adopting Release, 77 FR at 30734, note 1529, estimating the number of participants with notional positions exceeding $100 billion in 2012. The analysis contained in the Intermediary Adopting Release used a sample that ended in December 2011, aggregated the activity of DTCC accounts to the level of transacting agents, and did not attribute positions to parent companies. For the purposes of analysis of the final rules, the sample has been updated through the end of December 2012 and positions falling short of the $100 billion threshold have been attributed to parent companies.

154 The start of this decline predates the enactment of the Dodd-Frank Act and the proposal of rules thereunder, which is important to note for the purpose of understanding the economic baseline for this rulemaking. The timing of this decline seems to indicate that CDS market demand shrank prior to the enactment of the Dodd-Frank Act, and therefore the causes of this reduction in trading volume may be related to market dynamics and not directly related to the enactment of statutes

interdealer transactions has remained fairly constant and interdealer transactions continue to represent the bulk of trading activity, whether measured in terms of notional value or number of transactions (see Figure 2).

Figure 2: Global, notional trading volume in North American corporate single-name CDS by calendar year and the fraction of volume that is interdealer.



Against this backdrop of declining North American corporate single-name CDS activity, about half of the trading activity in North American corporate single-name CDS reflected in the

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and the development of security-based swap market regulation. If the security-based swap market experiences further declines in trading activity, it would be difficult to identify the effects of the newly developed security-based swap market regulation apart from changes in trading activity that may be due to natural market forces, or the anticipation of (or reaction to) proposed (or adopted) Title VII requirements or requirements being considered or implemented in other jurisdictions.

set of data we analyzed was between counterparties domiciled in the United States and counterparties domiciled abroad. Basing counterparty domicile on the self-reported registered office location of the DTCC-TIW accounts, the Commission estimates that only 13 percent of the global transaction volume by notional volume between 2008 and 2012 was between two U.S.-domiciled counterparties, compared to 48 percent entered into between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 39 percent entered into between two foreign-domiciled counterparties (see Figure 3).[155]

When the domicile of DTCC-TIW accounts are instead defined according to the domicile of their ultimate parents, headquarters, or home offices (e.g., classifying a foreign bank branch or foreign subsidiary of a U.S. entity as domiciled in the United States), the fraction of transactions entered into between two U.S.-domiciled counterparties increases to 29 percent, and to 53 percent for transactions entered into between a U.S.-domiciled counterparty and a foreign-domiciled counterparty.

Differences in classifications across different definitions of domicile illustrate the effect of participant structures that operate across jurisdictions. Notably, the proportion of activity between two foreign-domiciled counterparties drops from 39 percent to 18 percent when domicile is defined as the ultimate parent's domicile. As noted earlier, foreign subsidiaries of

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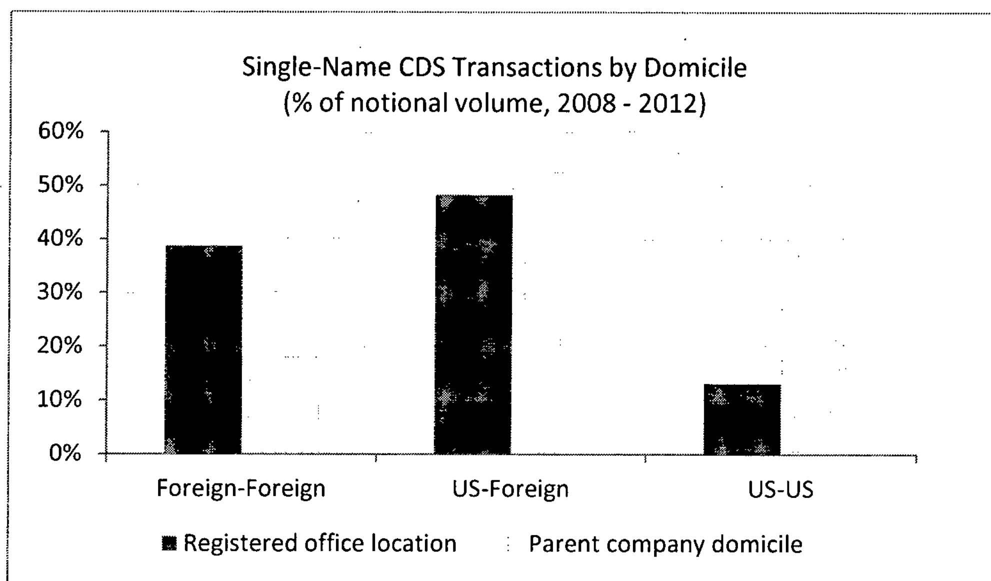
[155] Following publication of the Warehouse Trust Guidance on CDS data access, the DTCC-TIW surveyed market participants, asking for the physical address associated with each of their accounts (i.e., where the account is organized as a legal entity). This is designated the registered office location by the DTCC-TIW. When an account does not report a registered office location, we assume that the settlement country reported by the investment adviser or parent entity to the fund or account is the place of domicile. For purposes of this discussion, we have assumed that the registered office location reflects the place of domicile for the fund or account.

Changes to these estimates relative to figures presented in the proposing release represent additional data regarding new accounts in the time series as well as the use of a longer sample period.

U.S. parent companies and foreign branches of U.S. banks, and U.S. subsidiaries of foreign parent companies and U.S. branches of foreign banks may transact with U.S. and foreign counterparties. However, this decrease in share suggests that the activity of foreign subsidiaries of U.S. firms and foreign branches of U.S. banks is generally higher than the activity of U.S. subsidiaries of foreign firms and U.S. branches of foreign banks.

By either of those definitions of domicile, the data indicate that a large fraction of North American corporate single-name CDS transaction volume is entered into between counterparties domiciled in two different jurisdictions or between counterparties domiciled outside the United States. For the purpose of establishing an economic baseline, this observation indicates that a large fraction of security-based swap activity would be affected by the scope of any cross-border approach we take in applying the Title VII requirements. Further, the large fraction of North American corporate single-name CDS transactions between U.S.-domiciled and foreign-domiciled counterparties also highlights the extent to which security-based swap activity transfers risk across geographical boundaries, both facilitating risk sharing among market participants and allowing for risk transmission between jurisdictions.

Figure 3: The fraction of notional volume in North American corporate single-name CDS between (1) two U.S.-domiciled accounts, (2) one U.S.-domiciled account and one non-U.S.-domiciled account, and (3) two non-U.S.-domiciled accounts, computed from January 2008 through December 2012.



B. Global Regulatory Efforts

Efforts to regulate the swaps market are underway not only in the United States but also abroad. In 2009, leaders of the G20—whose membership includes the United States, 18 other countries, and the EU—called for global improvements in the functioning, transparency, and regulatory oversight of OTC derivatives markets agreeing that "all standardised OTC derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties ("CCPs") by end-2012 at the latest. OTC derivatives contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."[156] In subsequent summits, the G20 leaders have reiterated their commitment to OTC derivatives regulatory reform and encouraged international

[156] See G20 Leaders' Statement cited in note 16, supra.

consultation in developing standards for these markets.[157] The FSB monitors implementation of OTC derivatives reforms and provides progress reports to the G20.[158]

Pursuant to these commitments, jurisdictions with major OTC derivatives markets have taken steps toward substantive regulation of these markets, though the pace of regulation varies. This suggests that many foreign participants will face substantive regulation of their security-based swap activities that is intended to implement the G20 objectives and that may therefore address concerns similar to those addressed by rules the Commission has proposed but not yet adopted.

Foreign legislative and regulatory efforts have focused on five general areas: requiring post-trade reporting of transactions data for regulatory purposes, moving OTC derivatives onto organized trading platforms, requiring central clearing of OTC derivatives, establishing or enhancing capital requirements, and establishing or enhancing margin requirements for OTC derivatives transactions.

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[157] See e.g., G20 Leaders' St. Petersburg Declaration. See also G20 Meeting, Los Cabos, Mexico, June 2012, available at: http://www.treasury.gov/resource-center/international/g7-g20/Documents/Los%20Cabos%20Leaders%27%20Declaration.pdf; and G20 Meeting, Cannes, France, November 2011, available at: https://www.g20.org/sites/default/files/g20_resources/library/Declaration_eng_Cannes.pdf ("G20 Leaders' Cannes Declaration"). In the G20 Leaders' Cannes Declaration, the G20 Leaders agreed to develop standards on margin for non-centrally cleared OTC derivatives.

[158] The FSB has published seven progress reports on OTC derivatives markets reform implementation: FSB Progress Report April 2014 (available at: http://www.financialstabilityboard.org/publications/r_140408.pdf); September 2013 (available at: http://www.financialstabilityboard.org/publications/r_130902b.pdf), April 2013 (available at: http://www.financialstabilityboard.org/publications/r_130415.pdf), October 2012 (available at: http://www.financialstabilityboard.org/publications/r_121031a.pdf), June 2012 (available at: http://www.financialstabilityboard.org/publications/r_120615.pdf), October 2011 (available at: http://www.financialstabilityboard.org/publications/r_111011b.pdf) and April 2011 (available at: http://www.financialstabilityboard.org/publications/r_110415b.pdf) (collectively, "FSB Progress Reports") . The ODWG prepares the FSB Progress Reports. The Commission participates in the ODWG, both on its own behalf and as the representative of IOSCO, which is co-chair of the ODWG.

The first two areas of regulation should help improve transparency in OTC derivatives markets, both to regulators and market participants. Regulatory transaction reporting requirements have entered into force in a number of jurisdictions including the EU, Hong Kong SAR, Japan, and Singapore, and other jurisdictions are in the process of proposing legislation and rules to implement these requirements.[159] The European Parliament has adopted legislation for markets in financial instruments that addresses trading OTC derivatives on regulated trading platforms.[160] This legislation also should promote post-trade public transparency in OTC derivatives markets by requiring the price, volume, and time of OTC derivatives transactions conducted on these regulated trading platforms to be made public in as close to real time as technically possible.

Regulation of derivatives central clearing, capital requirements, and margin requirements aims to improve management of financial risks in these markets. Japan has rules in force mandating central clearing of certain OTC derivatives transactions. The EU has its legislation in place but has not yet made any determinations of specific OTC derivatives transactions subject to mandatory central clearing. Most other jurisdictions are still in the process of formulating their legal frameworks that govern central clearing. While the EU is the only major foreign jurisdiction that has initiated the process of drafting rules to implement margin requirements for OTC derivatives transactions, we understand that several other jurisdictions anticipate taking steps towards implementing such requirements.

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[159] Information regarding ongoing regulatory developments described in this section was primarily obtained from the FSB Progress Reports cited in note 158, supra, which reflect the input of relevant jurisdictions.

[160] Id.

C. Cross-Market Participation

Persons registered as security-based swap dealers or major security-based swap participants are likely also to engage in swap activity, which is subject to regulation by the CFTC. In the release proposing registration requirements for security-based swap dealers and major security-based swap participants, we estimated, based on our experience and understanding of the swap and security-based swap markets that of the 55 firms that might register as security-based swap dealers or major security-based swap participants, approximately 35 would also register with the CFTC as swap dealers or major swap participants.[161]

This overlap reflects the relationship between single-name CDS contracts, which are security-based swaps, and index CDS contracts, which may be swaps or security-based swaps. A single-name CDS contract covers default events for a single reference entity or reference security. These entities and securities are often part of broad-based indices on which market participants write index CDS contracts. Index CDS contracts and related products make payouts that are contingent on the default of index components and allow participants in these instruments to gain exposure to the credit risk of the basket of reference entities that comprise the index, which is a function of the credit risk of the index components. As a result of this construction, a default event for a reference entity that is an index component will result in payoffs on both single-name CDS written on the reference entity and index CDS written on indices that contain the reference entity. Because of this relationship between the payoffs of

[161] See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 65543 (Oct. 12, 2011), 76 FR 65784, 65808 (Oct. 24, 2011). Based on its analysis of 2012 DTCC-TIW and the list of swap dealers provisionally-registered with the CFTC, and applying the methodology used in the Intermediary Definitions Adopting Release, the Commission estimates that substantially all registered security-based swap dealers would also register as swap dealers with the CFTC. See also CFTC list of provisionally registered swap dealers, available at: http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer.

single-name CDS and index CDS products, prices of these products depend upon one another. This dependence is particularly strong between index CDS contracts and single-name CDS contracts written on index components.[162]

Because payoffs associated with these single-name CDS and index CDS are dependent, hedging opportunities exist across these markets. Participants who sell protection on reference entities through a series of single-name CDS transactions can lay off some of the credit risk of their resulting positions by buying protection on an index that includes a subset of those reference entities. Participants that are active in one market are likely to be active in the other. Commission staff analysis of approximately 4,400 DTCC-TIW accounts that participated in the market for single-name CDS in 2012 revealed that approximately 2,700 of those accounts, or 61 percent, also participated in the market for index CDS. Of the accounts that participated in both markets, data regarding transactions in 2012 suggest that, conditional on an account transacting in notional volume of index CDS in the top third of accounts, the probability of the same account landing in the top third of accounts in terms of single-name CDS notional volume is approximately 62 percent; by contrast, the probability of the same account landing in the bottom third of accounts in terms of single-name CDS notional volume is only 14 percent.

In an effort to comply with CFTC rules and applicable statutory provisions in the cross-border context, swap market participants, many of whom, as discussed above, likely also participate in the security-based swap market, may have already changed some market

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[162] "Correlation" typically refers to linear relationships between variables; "dependence" captures a broader set of relationships that may be more appropriate for certain swaps and security-based swaps. See, e.g., Casella, George and Roger L. Berger, "Statistical Inference" (2002), at 171.

practices.[163] Although a commenter suggested that swap market participants have already conformed their business practices to the CFTC's approach to cross-border regulation, the commenter did not supply particular details as to the scope of that operations restructuring.[164] We believe, however, based on these comments, it is likely that all participants who preliminarily believe they may be subject to the CFTC's registration requirements will have expended resources to build systems and infrastructure that will permit them to determine and then record the U.S.-person status of their counterparties consistent with applicable requirements, as interpreted by the CFTC Cross-Border Guidance.

The CFTC's rules and cross-border guidance have likely influenced the information that market participants collect and maintain about the swap transactions they enter into and the counterparties they face. For example, the CFTC's guidance describes a majority-ownership approach for collective investment vehicles that are offered to U.S. persons, contemplating that managers of these vehicles would assess, on an ongoing basis, the proportion of ownership by U.S. persons. As another example, the CFTC's guidance articulates an approach by which all

163 See, e.g., SIFMA/FIA/FSR Letter at 2-3. We understand that new capabilities have been built by swap market participants following issuance of the CFTC's guidance. To the extent that such capabilities can be transferred to these participants' security-based swap activities (e.g., to the extent that a market participant's assessment practices regarding whether a counterparty would generally be considered a U.S. person for purposes of the CFTC guidance also can help determine the corresponding assessment for purposes of these final rules and guidance), such capabilities may tend to mitigate the costs that market participants otherwise would incur in connection with the Commission's final cross-border rules.

164 Id. at 2-4. The commenter notes the "technological, operational, legal and compliance systems" necessary for complying with the Commission's proposed rules, and taking account of the CFTC Cross-Border Guidance, outlining the general categories of changes to practice necessary for compliance. The commenter further indicates a potential need to "build[] separate systems for a small percentage of the combined swaps and SBS market instead of using the systems already built for compliance with the CFTC's cross-border approach," suggesting that market participants have already altered market practices to follow the CFTC Cross-Border Guidance.

swap transactions by a non-U.S. person that rely on guarantees from U.S. affiliates would generally count against that non-U.S. person's dealer de minimis exception.[165]

Thus, as discussed in more detail in sections IV.I.2 and V.H.2 below, the adoption of rules that would seek similar information from security-based swap market participants as the CFTC seeks from swap market participants, may allow such participants to use infrastructure already in place as a result of CFTC regulation to comply with Commission regulation. Among those entities that participate in both markets, entities that are able to apply to security-based swap activity new capabilities they have built in order to comply with requirements applicable to cross-border swap activity may experience lower costs associated with assessing which cross-border security-based swap activity counts against the dealer de minimis exception or towards the major participant threshold, relative to those that are unable to redeploy such capabilities. The Commission remains sensitive to the fact that in cases where its final rules differ from the CFTC approach, additional outlays related to information collection and storage may be required even of market participants that conformed to the CFTC's guidance regarding the applicable cross-border requirements.[166] These costs are discussed in sections IV.I.1 and V.H.1(b).

IV. Cross-Border Application of Dealer De Minimis Exception

A. Overview

The Exchange Act excepts from designation as "security-based swap dealer" entities that engage in a "de minimis" quantity of security-based swap dealing activity with or on behalf of

165 See section IV.I.2(c), supra, for a discussion of costs to market participants that may arise from differences between the CFTC approach to guarantees and the Commission's final rules.

166 We recognize that the CFTC Cross-Border Guidance is the subject of ongoing litigation. Our economic analysis is not intended to draw any conclusions about the ultimate outcome of that litigation; rather, the economic analysis relies on the current practices and operational abilities of firms that are, we understand, either in accordance with the CFTC Cross-Border Guidance or are in the process of adapting their systems to account for the CFTC's approach to cross-border issues.

customers.[167] Under the final rules adopted in the Intermediary Definitions Adopting Release, a person may take advantage of that exception if, in connection with CDS that constitute security-based swaps, the person's dealing activity over the preceding 12 months does not exceed a gross notional amount of $3 billion, subject to a phase-in level of $8 billion.[168] The phase-in level will remain in place until – following a study regarding the definitions of "security-based swap dealer" and "major security-based swap participant" – the Commission either terminates the phase-in period or establishes an alternative threshold following rulemaking.[169]

To apply the exception to cross-border dealing activity, the Cross-Border Proposing Release would have required that a U.S. person count against the de minimis thresholds all of its security-based swap dealing activity, including transactions conducted through a foreign branch of a U.S. bank.[170] Non-U.S. persons, in contrast, would have included only dealing transactions entered into with U.S. persons other than foreign branches of U.S. banks, plus dealing transactions where the transaction is "conducted within the United States."[171] To implement, within the cross-border context, the existing rule that requires a person to aggregate the dealing activity of its affiliates against its own de minimis thresholds,[172] the proposal would have required a person to count: (i) dealing transactions by its affiliates that are U.S. persons; and (ii)

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[167] See Exchange Act section 3(a)(71)(D).

[168] See Exchange Act rule 3a71-2(a).

[169] See Intermediary Definitions Adopting Release, 77 FR at 30640-41; see also note 149, supra (addressing process for termination of phase-in level). Lower thresholds are set forth in connection with dealing activity involving other types of security-based swaps. See Exchange Act rule 3a71-2(a)(1)(ii).

[170] See proposed Exchange Act rule 3a71-3(b)(1)(i).

[171] See proposed Exchange Act rule 3a71-3(b)(1)(ii).

[172] See Exchange Act rule 3a71-2(a)(1) (providing that, for purposes of the de minimis exception, a person shall count its own dealing activity plus the dealing activity of "any other entity controlling, controlled by, or under common control with the person").

dealing transactions by non-U.S. affiliates that either are entered into with U.S. persons other than foreign branches, or that are conducted within the United States.[173] The proposal further would have permitted a person to exclude, from the de minimis analysis, transactions by affiliates that are registered security-based swap dealers, provided that the person's dealing activity is "operationally independent" from the registered dealer's dealing activity.[174] The proposal, moreover, set forth definitions relevant to the application of the de minimis exception in the cross-border context, including proposed definitions of the terms "U.S. person" and "transaction conducted within the United States."[175]

Commenters raised issues related to various aspects of this proposed approach to application of the de minimis exception in the cross-border context. As discussed below, these include issues regarding: the scope of the "U.S. person" definition, the proposal to require counting of certain "transactions conducted within the United States" between two non-U.S. persons, the treatment of the dealing activity of non-U.S. persons that is guaranteed by U.S. persons, and the application of the exception to non-U.S. persons whose counterparties are foreign branches of U.S. banks. Some commenters also urged us to more closely harmonize

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173 See proposed Exchange Act rule 3a71-3(b)(2).

174 See proposed Exchange Act rule 3a71-4.

175 The proposal also set forth definitions of "foreign branch" and "transaction conducted through a foreign branch" in connection with the de minimis exception. See proposed Exchange Act rule 3a71-3(a). The proposed definitions of "U.S. person," "transaction conducted within the United States," "foreign branch," and "transaction conducted through a foreign branch" also are relevant to the Commission's proposed rules regarding the cross-border application of certain other Title VII requirements. See, e.g., proposed Exchange Act regulation SBSR (regarding regulatory reporting and public dissemination).

Proposed Exchange Act rule 3a71-3 also contained a provision and associated definitions related to the cross-border application of counterparty protection requirements in connection with security-based swap activities. As discussed above, those matters are not the subject of the present rulemaking, and the Commission intends to address those matters as part of a subsequent rulemaking.

particular aspects of our proposal with the CFTC Cross-Border Guidance.

After considering commenters' views regarding the cross-border application of the de minimis exception, we are adopting final rules that have been modified from the proposal in certain important respects. While these changes are discussed in more detail below, key elements include:

- Modifications to the proposed definition of "U.S. person";
- Provisions to distinguish non-U.S. persons' dealing activity involving security-based swaps that are guaranteed by their U.S. affiliates from such non-U.S. persons' other dealing activity for purposes of the de minimis exception, by requiring a non-U.S. person to count against the de minimis thresholds all dealing activity involving security-based swaps for which its counterparty has rights of recourse against a U.S. guarantor that is affiliated with the non-U.S. person;
- Provisions to distinguish non-U.S. persons that act as conduit affiliates (by entering into certain security-based swap transactions on behalf of their U.S. affiliates) from other non-U.S. persons for purposes of the de minimis exception, in that conduit affiliates are required to count all of their dealing activity against the de minimis thresholds regardless of counterparty;
- Modifications to the application of the de minimis exception to dealing activity by non-U.S. persons when the counterparty is the foreign branch of a U.S. bank.
- The addition of an exclusion related to cleared, anonymous transactions; and
- Modifications of the proposed aggregation provisions, in part by removing the "operational independence" condition to excluding dealing positions of affiliates that are registered dealers.

The final rules we are adopting reflect a territorial approach that is generally consistent with the principles that the Commission traditionally has followed with respect to the registration of brokers and dealers under the Exchange Act. Under this territorial approach, registration and other requirements applicable to brokers and dealers generally are triggered by a broker or dealer physically operating in the United States, even if its activities are directed solely toward non-U.S. persons outside the United States. The territorial approach further generally requires broker-dealer registration by foreign brokers or dealers that, from outside the United States, induce or attempt to induce securities transactions by persons within the United States – but not when such foreign brokers or dealers conduct their activities entirely outside the United States.[176]

In the cross-border context, moreover, the application of the "security-based swap dealer" definition and its de minimis exception remains subject to general principles that we addressed in the Intermediary Definitions Adopting Release. Accordingly, the term "person" as used in the "security-based swap dealer" definition and in the Commission's rules implementing the de minimis exception should be interpreted to refer to a particular legal person, meaning that a trading desk, department, office, branch or other discrete business unit that is not a separately organized legal person will not be viewed as a security-based swap dealer. As a result, a legal person with a branch, agency, or office that is engaged in dealing activity above the de minimis threshold is required to register as a security-based swap dealer, even if the legal person's dealing activity is limited to such branch, agency, or office.[177]

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176 See Cross-Border Proposing Release, 78 FR at 30990; see generally section III.B, supra.

177 See Intermediary Definitions Adopting Release, 77 FR at 30624; see also Cross-Border Proposing Release at 30993.

Cross-border security-based swap transactions also are subject to the principle that transactions between majority-owned affiliates need not be considered for purposes of determining whether a person is a dealer.[178]

As discussed below, these final rules and guidance do not address the proposed provisions regarding the cross-border application of the dealer definition to "transactions conducted within the United States," as defined in the Cross-Border Proposing Release. We anticipate soliciting additional public comment on potential approaches for applying the dealer definition to non-U.S. persons in connection with activity between two non-U.S. persons where one or both are conducting dealing activity that occurs within the United States.[179]

B. Application of De Minimis Exception to Dealing Activities of U.S. Persons

1. Proposed Approach and Commenters' Views

Under the proposal, a U.S. person would have counted all of its security-based swap dealing activity against the de minimis thresholds, including transactions that it conducted through a foreign branch.[180] Although some persons who submitted comments in connection with the Intermediary Definitions Adopting Release expressed the view that dealing activity by foreign branches should not be counted as part of a U.S. person's de minimis calculation,[181] we did not propose such an approach.[182] Moreover, commenters to the Cross-Border Proposing

178 See Exchange Act rule 3a71-1(d).

179 See section I.A, supra.

180 See proposed Exchange Act rule 3a71-3(b)(1)(i).

181 See, e.g., ISDA Letter (Feb. 22, 2011) ("Non-U.S. entities (including non-U.S. affiliates and branches of U.S. banks) should not be required to register as Dealers when they are conducting business with non-U.S. counterparties"). This and other comments in connection with the Intermediary Definitions Adopting Release are located at: http://www.sec.gov/comments/s7-39-10/s73910.shtml.

182 We considered these comments in connection with the Cross-Border Proposing Release. See Cross-Border Proposing Release, 78 FR at 30990, 30994.

Release did not specifically express opposition to this aspect of the proposal, although several commenters addressed related issues regarding the proposed scope of the "U.S. person" definition.[183]

2. Final Rule

Consistent with the proposal, the final rules require U.S. persons to apply all of their dealing transactions against the de minimis thresholds, including activity they conduct through their foreign branches.[184] Such dealing transactions must be counted regardless of where they are arranged, negotiated, or executed.

As discussed above, it is our view that any dealing activity undertaken by a U.S. person, as defined in this final rule, occurs at least in part within the United States and therefore warrants the application of Title VII regardless of where particular aspects of dealing activity are conducted.[185] Whenever a U.S. person enters into a security-based swap in a dealing capacity, it is the U.S. person as a whole – and not merely any applicable foreign branch or office of that U.S. person – that holds itself out as a dealer in security-based swaps. It is the U.S. person as a whole that seeks to profit by providing liquidity and making a market in security-based swaps, and it is the financial resources of the U.S. person as a whole that enable it to do so. Even if the U.S. person engages in dealing activity through a foreign branch or office, its dealing counterparties will look to the entire U.S. person – and not merely its foreign branch or office – for performance on the transaction, and the U.S. person as a whole assumes and stands behind the obligations arising from the security-based swap, thereby creating risk to the U.S. person and

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[183] We address these comments in the context of our discussion of our final definition of "U.S. person.". See notes 192-231, infra, and accompanying text.

[184] See Exchange Act rule 3a71-3(b)(1)(i). Issues regarding how the de minimis exception applies to a non-U.S. person whose counterparty is a foreign branch are addressed in section IV.E.2, infra.

[185] See Cross-Border Proposing Release, 78 FR at 30994.

potentially to the U.S. financial system. A dealer that is organized or has its principal place of business in the United States thus cannot hold itself out as anything other than a single person, and generally cannot operate as a dealer absent the financial and other resources of that single person. Accordingly, we conclude that U.S. persons that engage in security-based swap dealing activity through foreign branches or offices should be subject to the regulatory framework for dealers even if those U.S. persons deal exclusively with non-U.S. persons.[186]

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[186] The definition of "U.S. person" is addressed below. The definitions of "foreign branch" and "transaction conducted through a foreign branch" are addressed in section IV.E.2, infra.

This interpretation, moreover, is consistent with the goals of security-based swap dealer regulation under Title VII. Security-based swap activity that results in a transaction involving a U.S. counterparty creates ongoing obligations that are borne by a U.S. person, and thus is properly viewed as occurring within the United States. The events associated with AIG FP, described in detail in our proposal, illustrate how certain transactions of U.S. persons can pose risks to the U.S. financial system even when they are conducted through foreign operations. See Cross-Border Proposing Release, 78 FR at 30980-81. Such risks, and their role in the financial crisis and in the enactment of Title VII, suggest that the statutory framework established by Congress and the objectives of Title VII would be undermined by an analysis that excludes from Title VII's application certain transactions involving U.S. persons solely because they involve conduct carried out through operations outside the United States, particularly when those transactions raise concerns about risk to the U.S. person and to the U.S. financial system that are similar or identical to those raised by such conduct when carried out by the U.S. person entirely inside the United States.

For the above reasons, we conclude that our approach does not apply to persons who are "transact[ing] a business in security-based swaps without the jurisdiction of the United States," within the meaning of section 30(c) of the Exchange Act. See section II.B.2(d), supra. A contrary interpretation would, in our view, reflect an understanding of what it means to conduct a security-based swaps business within the jurisdiction of the United States that is divorced both from Title VII's statutory objectives and from the reality of the role of U.S. persons within the global security-based swap market. But in any event we also believe that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Otherwise, U.S. persons could simply conduct dealing activities with non-U.S. persons using foreign branches and remain outside of the application of the dealer requirements of Title VII, bringing the same risk into the United States that would be associated with such dealing activity that is conducted out of their U.S. offices.

C. Definition of "U.S. Person"

1. Proposed Approach

Consistent with our territorial approach to application of Title VII to cross-border security-based swap activity, our Cross-Border Proposal defined "U.S. person" to mean:

- Any natural person resident in the United States;
- Any partnership, corporation, trust, or other legal person organized or incorporated under the laws of the United States[187] or having its principal place of business in the United States; and
- Any account (whether discretionary or non-discretionary) of a U.S. person.[188]

The Commission also proposed that the term "U.S. person" would exclude the following international organizations: the International Monetary Fund ("IMF"), the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies and pension plans.[189]

This proposed definition of "U.S. person" generally followed an approach to defining U.S. person that is similar to that used by the Commission in other contexts,[190] though it was

187 Proposed Exchange Act rule 3a71-3(a)(9) under the Exchange Act defined "United States" as "the United States of America, its territories and possessions, any States of the United States, and the District of Columbia."

188 Proposed Exchange Act rule 3a71-3(a)(7)(i) under the Exchange Act.

189 See proposed Exchange Act rule 3a71-3(a)(7)(ii).

190 See, e.g., Securities Act Release No. 6863 ("Regulation S Adopting Release") (April 24, 1990), 55 FR 18306, 18308 (May 2, 1990), 55 FR at 18308 (adopting regulation "based on a territorial approach to [s]ection 5 of the Securities Act"). Although the proposed rule followed the approach to defining "U.S. person" in Regulation S in certain respects, we stated that we preliminarily believed that it was necessary to depart from Regulation S in defining "U.S. person"

tailored to the specific goals of Title VII. As we noted in the proposal, we sought with the proposed definition to identify those types of individuals or entities whose security-based swap activity is likely to impact the U.S. market even if they transact with security-based swap dealers that are not U.S. persons and to identify those types of individuals or entities that are part of the U.S. security-based swap market and should receive the protections of Title VII.[191]

2. Commenters' Views

We received extensive comments on our proposed definition of "U.S. person." In these comments, many commenters also expressed their views on the interpretation of "U.S. person" in the CFTC Cross-Border Guidance. As explained in more detail below, several commenters emphasized that we should minimize divergence from the CFTC's approach, including by adding certain elements to our definition of "U.S. person" that we had not proposed. Many

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in the context of the cross-border application of Title VII. See Cross-Border Proposing Release, 78 FR at 31007-08 (comparing the proposed definition of "U.S. person" with the definition of "U.S. person" in Regulation S). For example, Regulation S expressly excludes foreign branches of U.S. banks from the definition of "U.S. person," whereas our proposed definition provided that U.S.-person status would be determined at the entity level, meaning that a foreign branch of a U.S. person would, as part of that U.S. person, share in that U.S.-person status of the entity as a whole. See section II.B.2(b)i, supra. Thus, under our proposed approach, the term "U.S. person" would have been interpreted to include any foreign trading desk, office, or branch of an entity that is organized under U.S. law or that has its principal place of business in the United States. See Cross-Border Proposing Release, 78 FR at 30996.

The proposed definition of "U.S. person" was similar in many respects to the definition provided by CFTC staff in its October 12, 2012 no-action letter. See Time-Limited No-Action Relief: Swaps Only With Certain Persons to be Included in Calculation of Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception and Calculation of Whether a Person is a Major Swap Participant (Oct. 12, 2012), available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-22.pdf; see also Final CFTC Cross-Border Exemptive Order, 78 FR at 862 (indicating that for purposes of its temporary conditional relief the CFTC is taking a similar approach to the "U.S. person" definition as that set forth in the October 12, 2012 no-action letter). In July 2013, the CFTC issued its cross-border guidance, which modified its interpretation of U.S. person in certain respects, discussed in greater detail below.

191 See Cross-Border Proposing Release, 78 FR at 30996.

commenters also identified specific elements of the CFTC interpretation that we should not adopt in our final rule.

(a) Definition of "U.S. Person" Generally

Several commenters expressed the view that our proposed definition of "U.S. person" was clear, objective, and territorial in scope.[192] At the same time, many commenters, including some who expressed agreement with our proposed approach, urged us to adopt, in whole or in part, a definition of "U.S. person" that is consistent with the interpretation of "U.S. person" in the CFTC Cross-Border Guidance.[193] In contrast, two commenters disagreed with our approach as being underinclusive and urged us to define U.S. person more broadly than the CFTC had interpreted it.[194] Two commenters addressed whether our "U.S. person" definition should follow

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192 See, e.g., SIFMA/FIA/FSR Letter at A-6 (stating that the Commission's proposed "U.S. person" definition was "clear, objective and ascertainable"); American Bar Association ("ABA") Letter at 1-2, 4 (commending the Commission for a "clear and objective" approach to the "U.S. person" definition that is consistent with its statutory authority and respects principles of comity); IIB Letter at 5 (stating that the Commission's proposed "U.S. person" definition is sensible in its jurisdictional scope and is consistent with territorial principles). But see EC Letter at 2 (generally supporting the territorial scope of the "U.S. person" definition, with the exception of the "principal place of business" requirement, arguing that it is inconsistent with the territorial approach); ESMA Letter at 2 (supporting a definition of "U.S. person" that covers only persons located or incorporated in the United States).

193 See, e.g., SIFMA/FIA/FSR Letter at 2-3, A-7 (suggesting that the Commission coordinate with the CFTC in order to provide a "consistent set of standards for determining an entity's principal place of business"); IIB Letter at 2 (noting that its recommendations are generally intended to emphasize consistency across regimes). See also Chris Barnard Letter at 2 (stating belief that the "U.S. person" definition should be aligned with the CFTC's definition, specifically with respect to commodity pools, pension plans, estates, and trusts); Japan Financial Markets Council ("JFMC") Letter at 4 (noting that, even though JFMC does not support all aspects of the CFTC's definition, it believes the Commission should adopt the same definition as the CFTC); Japan Securities Dealers Association ("JSDA") Letter at 3 (expressing hope that the Commission and the CFTC do not adopt different definitions of U.S. person); Investment Adviser Association ("IAA") Letter at 3 (noting that, given the finalization of the CFTC Cross-Border Guidance, the Commission should modify its proposal in several respects to be more consistent with the CFTC's definition of "U.S. person").

194 See AFR Letter I at 3, 5 (stating that the proposed definition of "U.S. person" is overly narrow because it does not include foreign subsidiaries of the seven largest U.S. bank holding companies); BM Letter at 5, 9, 14-15 (stating that the proposed definition of "U.S. person" is too

the U.S. person analysis in Regulation S.[195]

(b) Treatment of Investment Vehicles

In response to our questions about whether our proposed definition of "U.S. person" provided sufficient guidance to investment vehicles and similar legal persons, commenters generally requested guidance but expressed a range of views as to what guidance we should provide. One commenter requested that we ensure that foreign investment vehicles with a "U.S. nexus" be considered U.S. persons.[196] This commenter expressed support for what it described as our "complementary" proposed approach that would have required legal persons, including investment vehicles, to perform a principal place of business assessment to determine whether they are U.S. persons, and would have subjected all transactions conducted within the United States to Title VII requirements.[197] One commenter conversely argued that a "principal place of business" test for investment vehicles would be inappropriate.[198]

Several commenters requested that we provide additional guidance regarding the application of the "principal place of business" test to investment vehicles. Some commenters

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narrow because it excludes guaranteed affiliates and other affiliates in a control relationship with a U.S. person; further suggesting that, should such guaranteed entities, whether they are implicitly or explicitly guaranteed, not be considered U.S. persons, they be separately "ring-fenced" from their U.S. affiliate in order to ensure that the U.S. affiliate does not cover any of the guaranteed affiliates obligations; further stating that such entities are within the scope of the Commission's broad authority under Exchange Act section 30(c) to regulate cross-border activity).

195 See Citadel Letter at 3 (supporting our proposal to not rely on Regulation S as it would not capture certain foreign funds that the commenter believed should be considered U.S. persons); ICI Letter at 6 (recommending that our analysis be consistent with Regulation S because fund managers are accustomed to that definition). Cf. note 190, supra (describing elements of "U.S. person" definition contained in Regulation S).

196 See Citadel Letter at 2-3 (noting further that such an approach will ensure that these entities will be subject to clearing, reporting, and other transaction-level requirements).

197 See id.

198 See ICI Letter at 4-5 (arguing that a "principal place of business" test is inappropriate for investment vehicles because they generally have no employees or offices of their own).

specifically requested that we avoid diverging from the CFTC's interpretation of "U.S. person" in our own final definition.[199] One commenter urged us to help ensure that market participants are able to make rational and consistent determinations regarding the U.S.-person status of investment vehicles, and suggested that an appropriate test would look to the location of the person responsible for the fund's operational management, which the commenter identified as the person that establishes the investment vehicle and selects persons to carry out functions on behalf of the vehicle, as opposed to the person responsible for the fund's investment management activities.[200] Another commenter requested guidance regarding the application of the "principal place of business" test, while expressing support for using an approach similar to the CFTC Cross-Border Guidance.[201] One commenter requested that the location of an asset manager retained by a person not be the sole factor used to determine the person's principal place of business or U.S.-person status.[202]

A few commenters responded to our question whether the proposed definition should encompass funds that are majority-owned by U.S. persons, as the CFTC's interpretation does,

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[199] See IAA Letter at 3 (urging the Commission to coordinate with the CFTC to develop a consistent definition of principal place of business); SIFMA/FIA/FSR Letter at A-8 (urging harmonization with the CFTC).

[200] See IIB Letter at 6. But see ICI Letter at 5 n.13 (requesting that the U.S.-person status of an investment vehicle not turn on the location of the vehicle's activities, employees, or the offices of its sponsor or adviser because such considerations are not relevant to whether risk is transferred to the United States).

[201] See Citadel Letter at 2. This commenter suggested looking to those senior personnel responsible for implementing the investment vehicle's investment and trading strategy as well as those responsible for "investment selections, risk management decisions, portfolio management, or trade execution." See id.

[202] See IAA Letter at 4 (suggesting that the Commission follow the CFTC Cross-Border Guidance by specifically providing that non-U.S. persons are not U.S. persons simply by virtue of using a U.S.-person asset manager); SIFMA/FIA/FSA at A-8 (same).

with two commenters advocating against and three advocating in favor of such an approach.[203] One of the commenters that opposed such a test urged, however, that if we were to adopt such a test, the test be identical to the approach taken by the CFTC.[204]

One commenter suggested that we adopt the CFTC's approach by which collective investment vehicles that are offered publicly only to non-U.S. persons, and not offered to U.S. persons, would not generally be considered "U.S. persons."[205] Another commenter urged that the definition exclude "non-U.S. regulated funds" that are offered publicly only to non-U.S. persons but are offered privately to U.S. persons in certain specific circumstances.[206]

(c) Treatment of Legal Persons More Generally

Two commenters urged us to include in the definition of "U.S. person" guaranteed subsidiaries and affiliates of U.S. persons.[207] Alternatively, these commenters suggested that we

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203 Compare ICI Letter at 7 (arguing that a majority-ownership test is not workable for non-U.S. regulated funds that are offered publicly abroad because it may be impossible or inconsistent with local law to identify or reveal investor information) and IAA Letter at 4 (explaining that a majority-ownership test would capture non-U.S. funds with minimal nexus to the United States and present implementation challenges) with AFR Letter I at 8 (recommending that the U.S.-person status of investment vehicles be based on majority ownership and/or actual locations of the person, regardless of the location of incorporation), and Greenberger Letter I at 6-7 (making a similar argument with respect to CFTC's interpretation of U.S. person), and BM Letter at 10 (recommending that the "U.S. person" definition include collective investment vehicles that are majority-owned by U.S. persons).

204 See IAA Letter at 5.

205 See id. at 3, 5 (noting that the CFTC Cross-Border Guidance has been finalized and urging the Commission to adopt the CFTC approach to permit market participants to operate "under the certainty and clarity" of consistent definitions of U.S. persons).

206 See ICI Letter at 5-6 (noting that such investment vehicles have only minimal nexus to the United States and stating that institutional investors that invest in such funds would not expect U.S. law to apply to the vehicles' transactions).

207 See AFR Letter I at 3, 5-7 (stating that proposed definition is too narrow and would allow U.S. entities to avoid regulation and engage in regulatory arbitrage); BM Letter at 9, 11-15 (requesting that the "U.S. person" definition be broadened to include any person that is "indistinguishable" from a U.S. person, such as by implicit or explicit guarantees from a U.S. person, including any affiliate controlling, controlled by, or under common control with a person that is headquartered, incorporated, or otherwise residing in the United States). These commenters further argued that

should require dealing transactions with such persons to be included in the dealing counterparty's security-based swap dealer de minimis calculation.[208] However, another commenter supported our proposed approach not to look to whether a person's transactions are guaranteed by a U.S. person for purposes of determining that person's U.S.-person status, stating that our proposal to address such risk through major security-based swap participant registration was sufficient.[209]

One commenter suggested that the Commission follow the CFTC in including in its final "U.S. person" definition legal persons that are directly or indirectly majority-owned by one or more U.S. persons who bear unlimited responsibility for the obligations of that legal person, stating that such a provision is necessary to prevent evasion of Title VII.[210]

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the acknowledgement in the Cross-Border Proposing Release that guarantees of foreign entities by a U.S. person may subject the U.S. financial system to risk is inconsistent with a definition that does not include such entities in the "U.S. person" definition. See id. at 5-6; BM letter at 8, 12. Cf. AFR Letter II at 2 (urging CFTC to include guaranteed affiliates in of U.S. persons in the interpretation of U.S. person); Greenberger Letter II at 3, 16 (requesting that the CFTC classify foreign subsidiaries of U.S. financial institutions as U.S. persons); AFR letter to CFTC, dated August 13, 2012 ("AFR Letter III") (stating that the CFTC's Final Exemptive Order Regarding Compliance with Certain Swap Regulation, 78 FR 858, will pose a risk to U.S. taxpayers due to the delay in applying requirements to foreign affiliates of U.S. banks) (incorporated by reference in AFR Letter I); Michael Greenberger letter to CFTC, dated August 13, 2012 ("Greenberger Letter III") (incorporated by reference in AFR Letter I).

208 See AFR Letter I at 7; BM Letter at 17 (stating that the exclusion from the de minimis calculation for guaranteed transactions is "indefensible" and "must be eliminated"). See also Chris Barnard Letter at 2 (stating that Title VII should apply to transactions involving a guarantee by a U.S. person).

209 See SIFMA/FIA/FSR Letter at A-11 to A-12 (stating that to treat the existence of a U.S. parent as relevant to determining whether a person is a U.S. person would disregard the legal independence of affiliates and imply that persons within the same corporate group necessarily coordinate their security-based swap activities).

210 See BM Letter at 10. Cf. CFTC Cross-Border Guidance, 78 FR at 45312.

One commenter expressed support for a principal place of business component to the "U.S. person" definition as set forth in our proposal.[211] Several commenters requested that the Commission provide additional guidance regarding relevant factors in identifying a legal person's principal place of business.[212] One commenter suggested that the location of a company's headquarters should be determinative and that a particular legal person should have only one principal place of business.[213]

Several commenters suggested that the Commission harmonize its approach to determining a person's principal place of business to the approach in the CFTC Cross-Border Guidance,[214] while at least one commenter suggested that the Commission work with the CFTC to develop a new, common definition.[215] At least two commenters, on the other hand, objected to the use of a "principal place of business" test.[216] One commenter suggested an alternative

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211 See Citadel Letter at 2 (stating that Commission was correct to incorporate a principal place of business determination into the "U.S. person" definition).

212 See IIB Letter at 5 (noting the difficulty of implementing the "principal place of business" test without further guidance and requesting the Commission to provide workable criteria); ABA Letter at 2-3 (requesting clarification of "principal place of business" test and recommending that the Commission confirm that an entity may rely on its counterparty's written representations regarding the counterparty's principal place of business).

213 See IIB Letter at 5-6. Another commenter suggested that the location of the personnel directing the security-based swap activity of the legal person be determinative. See Citadel Letter at 2.

214 See JFMC Letter at 4 (notwithstanding burdensome aspects of the CFTC's interpretation, and the difficulties of the "principal place of business" test in particular, urging the Commission to adopt the same definition as the CFTC); SIFMA/FIA/FSR Letter at A-8 (explaining the difficulty in having to determine a counterparty's principal place of business under two different standards); Citadel Letter at 2 (requesting that the Commission provide further guidance "to parallel the CFTC's guidance" on principal place of business).

215 See IAA Letter at 3 (urging that, if the Commission adopts a "principal place of business" test, it coordinate with the CFTC to develop a consistent and harmonized definition).

216 See ESMA Letter at 2 (arguing that the "U.S. person" definition should be limited to entities that are established within the United States and should not in any case extend to an entity, such as a U.S. branch of a foreign bank, whose presence in the United States is "complementary" to its principal activity outside the United States and which is already regulated by a non-U.S. jurisdiction); JSDA Letter at 3 (recommending that the Commission and the CFTC eliminate the

approach that would establish criteria for this determination, such as quantitative thresholds, and would also consider not requiring a principal place of business analysis if the jurisdiction of incorporation has an acceptable regulatory framework.[217] Another commenter stated that a U.S. branch of a person established in another jurisdiction should not be considered to have its principal place of business in the United States.[218] Another suggested that requiring a principal place of business analysis represented a departure from the Commission's stated territorial approach to U.S. person.[219]

Several commenters recommended that, if the Commission were to adopt a "principal place" of business test in its "U.S. person" definition, market participants be allowed to rely on a counterparty's representations as to the counterparty's principal place of business.[220] Another suggested that the test look to information found in the public filings of a public company or, with respect to a private company, the location of its business.[221]

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principal place of business concept from their respective criteria for identifying U.S. persons). See also EC Letter at 2 (supporting the territorial approach of the "U.S. person" definition, but suggesting that the "principal place of business" test is not territorial and suffers from ambiguity);

217 See EC Letter at 2. See also ESMA Letter at 2 (requesting that the Commission provide clarity with respect to its proposed "U.S. person" definition, particularly the "principal place of business" test).

218 See ESMA Letter at 2 (noting that to include such persons would place potentially duplicative and conflicting requirements on the person in the case of European persons that would also be subject to the European Market Infrastructure Regulation).

219 See EC Letter at 2.

220 See ABA Letter at 2-3 (stating that entities should be able to rely on their counterparty's written representations "absent evidence to the contrary," regarding their principal place of business); JSDA Letter at 3 (recommending that, if the Commissions determine to keep a "principal place of business" test, they permit entities to rely on counterparty representations); IIB Letter at 5 n.9 (recommending that a counterparty representation as to U.S.-person status be sufficient to fulfill a person's diligence requirements). One of these commenters specifically requested that the reasonable reliance standard be limited to representations regarding principal place of business. See ABA letter at 3 n.2.

221 See IIB Letter at 6.

(d) Accounts

One commenter supported the Commission's proposal for determining the U.S.-person status of an account, which would look to whether the owner of the account itself is a U.S. person,[222] but suggested that the Commission provide bright-line thresholds to clarify that de minimis ownership by U.S. persons would not cause the account to be considered a U.S. person.[223] The commenter further requested that the Commission clarify that the "account" prong of the "U.S. person" definition would not apply to collective investment vehicles but was intended to capture persons that should be considered U.S. persons even though they are conducting trades, as the direct counterparty, through an account.[224]

(e) International Organizations

A number of commenters expressed support for the Commission's proposal to exclude certain international organizations (e.g., multilateral development banks, or "MDBs") from the "U.S. person" definition.[225] Three commenters specifically requested that the Commission list

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222 See SIFMA/FIA/FSR Letter at A-8.

223 See id. at A-9. See also IAA Letter at 4-5 (requesting that, should the Commission adopt an ownership test, it adopt a test consistent with and no more restrictive than the CFTC test for collective investment vehicles).

224 See SIFMA/FIA/FSR Letter at A-8 to A-9. Another commenter expressed disagreement with the Commission's proposed treatment of accounts in the "U.S. person" definition, expressing concern that inclusion of accounts in the definition may affect the U.S.-person status of funds. See IAA Letter at 4 (explaining that an ownership test applying to accounts would potentially capture non-U.S. funds that may have U.S. investors but whose "purposeful activities" such as "marketing or offering" are not aimed at U.S. persons, meaning the fund would have "little nexus to the U.S.").

225 See SIFMA/FIA/FSR Letter at A-10 (supporting an exclusion for all Foreign Public Sector Financial Institutions (including MDBs) ("FPSFIs") and their affiliates from the "U.S. person" definition); JFMC Letter at 4 (supporting an exclusion from "U.S. person" definition for FPSFIs and their affiliates); JSDA letter at 3 (supporting the Commission's proposed exclusion from the "U.S. person" definition for certain "international organizations" and expressing support for an exclusion for FPSFIs); International Bank for Reconstruction and Development, International Finance Corporation et al. Letter ("WB/IFC Letter") at 1, 6 (supporting an exclusion for multilateral development institutions and their affiliates from the "U.S. person" definition, and

all such institutions that would be excluded from the "U.S. person" definition, similar to the approach the CFTC took in its guidance,[226] rather than refer to "other similar international organizations."[227] These commenters also argued that certain organizations have absolute immunity under federal law and should be excluded from regulation under Title VII entirely.[228] Three commenters requested that affiliates of MDBs and similar organizations also be excluded from the definition of "U.S. person."[229]

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noting that such affiliates are excluded under Regulation S as well); IDB Letter at 1 (requesting that MDBs and their affiliates not be considered U.S. persons).

226 See Sullivan and Cromwell ("SC") Letter at 18 and n.20; WB/IFC Letter at 4-5 (suggesting that to avoid confusion, the Commission expressly include other MDBs that maintain headquarters in Washington, DC and identify those organizations which include IFC, the International Development Association, the Multilateral Investment Guarantee Agency, and the Inter-American Investment Corporation); IIB Letter at 5 (supporting an exclusion from U.S.-person status for "international organizations" similar to those already enumerated in the Cross-Border Proposing Release, and stating that such an exclusion would be consistent with the CFTC Cross-Border Guidance and "well-established" principles of international law); Inter-American Development Bank ("IDB") Letter at 2 (stating that it shares the position of the International Finance Corporation and the International Bank for Reconstruction and Development that the Commission's approach to MDB's should be consistent with the CFTC). See also Intermediary Definitions Adopting Release, 77 FR at 30692 n.1180 (listing international financial institutions for purposes of CFTC requirements); CFTC Cross-Border Guidance, 78 FR at 45353 n.531 (incorporating list provided in Intermediary Definitions Adopting Release by reference).

227 Proposed Exchange Act rule 3a71-3(a)(7)(ii).

228 See SC Letter at 3-4, 7-9, 12-14; WB/IFC letter at 2. See also IDB Letter at 1 (requesting confirmation that MDBs will not be subject to Commission's requirements with respect to security-based swaps and indicating that such an approach would respect its privileges and immunities).

229 See SC Letter at 19-22 (requesting that, in response to footnote 301 of the Cross-Border Proposing Release, "controlled affiliates" of MDBs not be treated as U.S. persons); IDB Letter at 1 (requesting that affiliates of international organizations not be treated as U.S. persons); WB/IFC Letter at 1, 6 (supporting an exclusion for multilateral development institutions and their affiliates from the "U.S. person" definition, and noting that such affiliates are excluded under Regulation S as well). One commenter suggested that this exclusion be made available for a "controlled affiliate," defined as follows: (1) an entity subject to the MDB's governance structure; (2) all of whose activities must be consistent with and in furtherance of the MDB's purpose and mission; (3) whose governing instruments restrict it to engaging in activities in which the MDB could itself engage and provide that it is not authorized to engage in any other activities; and (4) which is under the "control" of the MDB as that term is used in securities laws (Securities Act Rule 405). See also note 225, supra.

(f) Status Representations

Some commenters requested that a potential dealer expressly be permitted to rely on a counterparty representation to fulfill its diligence requirements in determining whether its counterparty is a U.S. person under the final rule.[230] Several commenters, as discussed above, specifically requested that we permit reliance on representations as to a person's principal place of business.[231] Two commenters requested that market participants be permitted to rely on the representations prepared by counterparties under the CFTC Cross-Border Guidance.[232]

3. Final Rule

Consistent with the proposal, we are adopting a final definition of "U.S. person" that continues to reflect a territorial approach to the application of Title VII and is in most respects unchanged from the proposal.[233] In response to comments, the final definition reflects certain changes intended to clarify the scope of the definition. Also in response to comments, we are adopting a general definition of "principal place of business" and a specific application of the term to externally managed investment vehicles. We are also adding a prong relating specifically to the U.S.-person status of estates.

The final rule defines "U.S. person" to mean:

- Any natural person resident in the United States;

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230 See IIB Letter at 5 n.9. This commenter suggested that we should permit reliance on a representation "absent knowledge of facts that would cause a reasonable person to question the accuracy of the representation." See also JSDA Letter at 3.

231 See note 220, supra.

232 See SIFMA/FIA/FSR Letter at A-8 (noting that performing a separate analysis would be burdensome); IIB Letter at 5, note 9 (noting that the CFTC's interpretation of "U.S. person" is broader than, and encompasses the three elements of, the Commission's proposed "U.S. person" definition).

233 Cf. note 192, supra (citing comment letters expressing general agreement with our territorial approach to defining U.S. person).

- Any partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;
- Any account (whether discretionary or non-discretionary) of a U.S. person; or
- Any estate of a decedent who was a resident of the United States at the time of death.[234]

The final rule defines "principal place of business" to mean "the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person."[235] It also provides that, with respect to an externally managed investment vehicle, this location "is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle."[236]

Also consistent with the proposal, the final definition excludes the following international organizations from the definition of "U.S. person": the IMF, the International Bank for

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234 Exchange Act rule 3a71-3(a)(4)(i). The second prong has been modified from the proposal to include an express reference to "investment vehicle" and to clarify that any legal person "established" under United States law is a U.S. person, as discussed further below. See Exchange Act rule 3a71-3(a)(4)(i)(B). The fourth prong has been added to include an express reference to "estate." See Exchange Act rule 3a71-3(a)(4)(i)(D). In the text of the final rule we have made a technical change to the proposal to clarify that the "U.S. person" definition is met if any one of the applicable prongs is satisfied (in part by replacing "and" with "or" in connection with the enumeration of the prongs). See Exchange Act rule 3a71-3(a)(4)(i).

Consistent with the proposal, "special entities," as defined in section 15F(h)(2)(C) of the Exchange Act, are U.S. persons because they are legal persons organized under the laws of the United States. Section 15F(h)(2)(C) of the Exchange Act defines the term "special entity" as: a Federal agency; a State, State agency, city, county, municipality, or other political subdivision of a State; any employee benefit plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1002; any governmental plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1002; or any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986. 15 U.S.C. 78o-10(h)(2)(C).

235 Exchange Act rule 3a71-3(a)(4)(ii).

236 Id.

Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies and pension plans.[237]

To address commenters' requests,[238] the final rule also has been revised from the proposal to provide that a person may rely on a counterparty's representation regarding its status as a U.S. person, unless such person knows, or has reason to know, that the representation is inaccurate.[239]

Although one commenter requested that we use a definition of "U.S. person" that is consistent with Regulation S, we are declining to do so for the reasons described in our Cross-Border Proposing Release.[240] We acknowledge that many market participants are accustomed to Regulation S and may find such a definition relatively easy to implement. As we discussed in our proposal, however, Regulation S addresses different concerns from those addressed by Title VII.[241] In light of these differences, the Commission believes that adopting the definition of "U.S. person" in Regulation S would not achieve the goals of Title VII and that a definition of U.S. person specifically tailored to the regulatory objectives it is meant to serve, as we are adopting here, is appropriate.

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237 Exchange Act rule 3a71-3(a)(4)(iii).

238 See notes 220, 230, supra.

239 Exchange Act rule 3a71-3(a)(4)(iv).

240 See note 195, supra.

241 See 17 CFR 230.901(k); Regulation S Adopting Release, 55 FR at 18306. See also Cross-Border Proposing Release, 78 FR at 31007 (describing differences between policy concerns underlying Regulation S and Title VII). For example, with its exclusions for certain foreign branches and agencies of U.S. persons from the definition of "U.S. person," Regulation S would not address the entity-wide nature of the risks that Title VII seeks to address. See id.

(a) Natural Persons

As in our proposed definition, the final definition of "U.S. person" provides that any natural person resident in the United States[242] is a U.S. person. This definition encompasses persons resident within the United States regardless of the individual's citizenship status,[243] but it does not encompass individuals who are resident abroad, even if they possess U.S. citizenship.[244]

As we noted in the proposal, it is consistent with the approach we have taken in prior rulemakings relating to the cross-border application of certain similar regulatory requirements to subject natural persons residing within the United States to our regulatory framework.[245] Moreover, we believe that natural persons residing within the United States who engage in security-based swap transactions are likely to raise the types of concerns intended to be addressed by Title VII, including those related to risk, transparency, and counterparty protection.[246] We believe that it is reasonable to infer that a significant portion of such persons' financial and legal relationships are likely to exist within the United States and that it is therefore reasonable to conclude that risks arising from the security-based swap activities of such persons

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242 Exchange Act rule 3a71-3(a)(5) defines "United States" to mean "the United States of America, its territories and possessions, any State of the United States, and the District of Columbia."

243 Exchange Act rule 3a71-3(a)(4)(i)(A).

244 This approach to treating natural persons as U.S. persons solely based on residence, rather than citizenship, differs from the approach to legal persons, such as partnerships and corporations, discussed below.

Notwithstanding slight differences between the language of our final rule and the CFTC Cross-Border Guidance, we expect that a natural person's U.S.-person status under our final definition would be the same as under the CFTC Cross-Border Guidance. Cf. note 193, supra (citing commenters urging the Commission to harmonize its definition of "U.S. person" with the interpretation set forth by the CFTC).

245 See Rule 15a-6 Adopting Release, 54 FR at 30017 (providing that foreign broker-dealers soliciting U.S. investors abroad generally would not be subject to registration requirements with the Commission).

246 See Cross-Border Proposing Release, 78 FR at 30996.

could manifest themselves within the United States, regardless of the location of their counterparties.

(b) Corporations, Organizations, Trusts, Investment Vehicles, and Other Legal Persons

The final definition of "U.S. person" as applied to legal persons has been modified to clarify certain aspects of the rule. Also, in response to comments, we are adopting a definition of "principal place of business." In general, the scope of the definition as applied to legal persons does not differ materially from the scope of our proposal.[247]

i. Entities incorporated, organized, or established under U.S. law

As with the proposed rule, the final definition provides that any partnership, corporation, trust, or other legal person organized or incorporated under the laws of the United States or having its principal place of business in the United States would be a U.S. person.[248] The final definition also includes two changes that are intended to make explicit certain concepts that were implicit in the proposed definition. First, the final rule provides that a legal person "established" under the laws of the United States is a U.S. person, just as if it had been "organized" or "incorporated" under the laws of the United States. This change is intended to clarify the Commission's intention that any person formed in any manner under the laws of the United States will be a U.S. person for purposes of Title VII.

Second, the final rule adds an express reference to "investment vehicle" in the non-exclusive list of legal persons to clarify that any such person, however formed, will be treated as a U.S. person for purposes of Title VII if it is organized, incorporated, or established under the

247 Moreover, we expect that a legal person's U.S.-person status under the Commission's final definition of "U.S. person" and under the definition "principal place of business" would as a general matter be the same as under similar prongs on the CFTC Cross-Border Guidance.

248 See Exchange Act rule 3a71-3(a)(4)(i)(B).

laws of the United States or has its principal place of business in the United States.[249] Investment vehicles are commonly established as partnerships, trusts, or limited liability entities and, therefore, fall within the scope of the rule as proposed. However, given the significant role that such vehicles have played and likely will continue to play in the security-based swap market, we believe that the final rule should incorporate an express reference to such vehicles to avoid any ambiguity regarding whether the definition of "U.S. person," including the principal place of business component of that definition, applies to them.

As noted in our proposal, we have previously looked to where a legal person is organized, incorporated, or established to determine whether it is a U.S. person.[250] We continue to believe that place of organization, incorporation, or establishment is relevant in the context of Title VII. In our view, the decision of a corporation, trustee, or other person to organize under the laws of the United States indicates a degree of involvement in the U.S. economy or legal system that warrants subjecting it to security-based swap dealer or major security-based swap participant registration requirements under Title VII if its security-based swap dealing activity or its security-based swap positions exceed the relevant thresholds.[251] We believe that it is reasonable to infer that an entity incorporated, organized, or established under the laws of the United States is likely to have a significant portion of its financial and legal relationships in the United States and that it is therefore reasonable to conclude that the risks arising from its security-based swap activities are likely to manifest themselves in the United States, regardless

[249] Cf. Cross-Border Proposing Release, 78 FR at 30997 n.296 (using funds and special-purpose investment vehicles as examples of other legal persons that may be U.S. persons).

[250] See Regulation S Adopting Release, 55 FR at 18316.

[251] Cf. EC Letter at 2 (expressing support for this approach); ESMA letter at 1 (same).

of the location of its counterparties. Accordingly, the final rule retains this element of the definition.

As under the proposal, the final definition determines a legal person's status at the entity level and thus applies to the entire legal person, including any foreign operations that are part of the U.S. legal person. Consistent with this approach, a foreign branch, agency, or office of a U.S. person is treated as part of a U.S. person, as it lacks the legal independence to be considered a non-U.S. person for purposes of Title VII even if its head office is physically located within the United States. We continue to believe that there is no basis to treat security-based swap transactions or positions of a foreign branch, agency, or office of a U.S. person differently from similar transactions or positions of the home office for purposes of the dealer de minimis or major security-based swap participant threshold calculations, given that the legal obligations and economic risks associated with such transactions or positions directly affect the entire U.S. person.

Under the final definition, the status of a legal person as a U.S. person has no bearing on whether separately incorporated or organized legal persons in its affiliated corporate group are U.S. persons. Accordingly, a foreign subsidiary of a U.S. person is not a U.S. person merely by virtue of its relationship with its U.S. parent. Similarly, a foreign person with a U.S. subsidiary is not a U.S. person simply by virtue of its relationship with its U.S. subsidiary. Although two commenters urged that most foreign affiliates of U.S. persons be treated as U.S. persons themselves,[252] we continue to believe that it is appropriate for each affiliate to determine its U.S.-

[252] See note 194, supra (citing AFR and BM Letters). One of these commenters argued that the final definition of "U.S. person" should include guaranteed foreign affiliates of U.S. persons, whether the guarantee is explicit or implicit, and that affiliates should be presumed to be receiving guarantees. See AFR Letter I at 3, 5-7. The other urged that the final definition of "U.S. person"

person status independently, given the distinct legal status of each of the affiliates, and that such status should turn on each affiliate's place of incorporation, organization, or establishment, or on its principal place of business.[253] We recognize that certain foreign persons, including foreign persons whose security-based swap activity is subject to a recourse guarantee against a U.S. person, may create risk to persons within the United States such as counterparties or guarantors.[254] We continue to believe, however, that, to the extent that such persons are established under the laws of a foreign jurisdiction and have their principal place of business abroad, they should not be included in the definition of "U.S. person."[255] As discussed in further

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include guaranteed foreign affiliates and "de facto guaranteed" affiliates of U.S. persons that may not be explicitly guaranteed. See BM Letter at 9, 11-15.

253 But see section IV.F, infra (discussing the aggregation of affiliate positions for purposes of the de minimis calculation).

254 See note 207 (citing AFR and BM Letters).

255 As we noted above, our "U.S. person" definition is intended to identify those persons whose financial and legal relationships are likely to be located in significant part within the United States. The mere fact of an affiliate relationship with, or a guarantee from, a U.S. person does not appear to us to indicate that such person has such relationships within the United States. Similarly, the mere fact that a person's security-based swap activity poses some degree of risk to the United States does not necessarily indicate that the person has the types of financial and legal relationships within the United States that warrant treating it as a U.S. person. However, we recognize that non-U.S. persons may in fact pose risk to the United States, particularly when their security-based swap transactions are subject to a recourse guarantee against a U.S.-person affiliate, and, even though we do not include them in our "U.S. person" definition, we do address such risk through our final rules applying the security-based swap dealer de minimis exception and the major security-based swap participant thresholds.

One commenter also urged us to follow the CFTC in including within the final definition any legal person that is directly or indirectly majority-owned by one or more U.S. persons that bear unlimited responsibility for the obligations and liabilities of such legal person. See note 210, supra (citing BM Letter). Cf. CFTC Cross-Border Guidance, 78 FR at 45312, 45317. Although we recognize that such persons give rise to risk to the U.S. financial system, as with non-U.S. persons whose security-based swap transactions are subject to explicit financial support arrangements from U.S. persons, we do not believe that it is appropriate in the context of security-based swap markets to treat such persons as U.S. persons given that they are incorporated under foreign law, unless their principal place of business is in the United States. See Exchange Act rule 3a71-3(a)(4)(i)(B). Moreover, to the extent that a non-U.S. person's counterparty has recourse to a U.S. person for the performance of the non-U.S. person's obligations under a security-based swap by virtue of the U.S. person's unlimited responsibility for

detail below, we believe that our final rules regarding application of the dealer de minimis exception and the major security-based swap participant thresholds adequately address concerns about the treatment of these persons under the dealer and major participant definitions without categorizing them as U.S. persons.[256]

ii. Entities having their principal place of business in the United States

a. In general

Consistent with our proposal, we are defining "U.S. person" to include persons that are organized, incorporated, or established abroad, but have their principal place of business in the United States. For purposes of this final rule, and in response to commenters' request for further guidance,[257] we are defining "principal place of business" generally to mean "the location from

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the non-U.S. person, the non-U.S. person would be required to include the security-based swap in its own dealer de minimis calculations (if the transaction arises out of the non-U.S. person's dealing activity) and its major participant threshold calculations. See sections IV.E.1 and V.D.3, infra. For example, if a counterparty to a transaction is a general partnership that is not a U.S. person but has a U.S.-person general partner that has unlimited responsibility for the general partnership's liabilities, including for its obligations to security-based swap counterparties, we would view the general partner's obligations with respect to the security-based swaps of the partnership as recourse guarantees for purposes of this final rule, absent countervailing factors.

256 See section IV.E.1 (describing application of de minimis exception to transactions of non-U.S. persons that are subject to a recourse guarantee against a U.S. person) and section V.D.3 (describing application of major security-based swap participant threshold calculations to positions of non-U.S. persons that are subject to a recourse guarantee against a U.S. person), infra. As discussed above, we will address the application of other Title VII requirements to these persons in subsequent releases.

257 In the proposing release, we did not provide guidance regarding the meaning of "principal place of business," but we requested comment whether such guidance was desirable, including whether it would be appropriate to adopt a definition similar to that adopted in rules under the Investment Advisers Act. See Cross-Border Proposing Release, 78 FR at 30999 n.306 (noting that the focus of one possible definition would be similar to that of the definition used in rules promulgated under the Investment Advisers Act, which define principal place of business as "the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser") (citing 17 CFR 275.222-1(b)). As noted above, several commenters requested that we provide guidance regarding the concept, and some provided suggested interpretations of the phrase with respect to operating companies and investment vehicles. See, e.g., note 213, supra (citing IIB Letter). See also SIFMA/FIA/FSR letter at A-8; Citadel Letter at 2. Several of these commenters urged us to

which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person."[258] As with the "U.S. person" definition more generally, our definition of "principal place of business" is intended to identify the location where a significant portion of the person's financial and legal relationships would be likely to exist, and we think it is reasonable to assume, for purposes of this final rule, that this location also generally corresponds to the location from which the activities of the person are primarily directed, controlled, and coordinated. In our view, to the extent that this location is within the United States, it is reasonable to conclude that the risks arising from that entity's security-based swap activity could manifest themselves within the United States, regardless of location of its counterparties.

This definition is intended to help market participants make rational and consistent determinations regarding whether their (or their counterparty's) principal place of business is in the United States.[259] Under the final rule, the principal place of business is in the United States if

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minimize divergence from the approach taken subsequent to our proposal by the CFTC in its July 2013 guidance (or from likely outcomes under that approach). See note 214, supra (citing letters from JFMC, SIFMA/FIA/FSR, Citadel, and IAA). Another commenter urged us to work closely with the CFTC in developing guidance regarding the meaning of principal place of business. See note 215, supra (citing IAA Letter).

[258] Exchange Act rule 3a71-3(a)(4)(ii). Cf. 17 CFR 275.222-1(b) (defining principal place of business for investment advisers under the Investment Advisers Act to mean "the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser").

Because the definition of "principal place of business" in this final rule is tailored to the unique characteristics of the security-based swap market, it does not limit, alter, or address any guidance regarding the meaning of the phrase "principal place of business" that may appear in other provisions of the federal securities laws, including the Investment Advisers Act, Commission rules, regulations, interpretations, or guidance.

[259] Cf. IIB Letter at 6 (urging an approach that "enable[s] market participants to reach rational, consistent U.S. person determinations for funds"). We also believe that our definition of "principal place of business" should reduce the potential that a particular entity would have a different U.S.-person status by virtue of the "principal place of business" prong under our definition and under the CFTC Cross-Border Guidance.

the location from which the overall business activities of the entity are primarily directed, controlled, and coordinated is within the United States. With the exception of externally managed entities, as discussed further below, we expect that for most entities the location of these officers, partners, or managers generally would correspond to the location of the person's headquarters or main office.[260]

Although we recognize that several commenters objected to including a "principal place of business" test in our definition of "U.S. person,"[261] we believe that a definition that focused solely on whether a legal person is organized, incorporated, or established in the United States could encourage some entities to move their place of incorporation to a non-U.S. jurisdiction to avoid complying with Title VII, while maintaining their principal place of business—and thus, reasonably likely, risks arising from their security-based swap transactions—in the United

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As discussed in further detail below, we also are including in our definition of "U.S. person" a provision permitting persons to rely on representations from a counterparty regarding whether the counterparty's principal place of business is in the United States, unless these persons know or have reason to know that the representation is false. See section IV.C.4, infra. Cf. note 220, supra (citing letters requesting that the Commission's final rule permit reliance on representations regarding principal place of business). This provision should further facilitate consistent application of the "U.S. person" to specific entities across market participants. We are not, however, specifically providing that entities may rely solely on representations prepared by counterparties under the CFTC Cross-Border Guidance, see note 232, supra, given that the CFTC has articulated a facts-and-circumstances approach to the principal place of business determination that is susceptible to significant further development and interpretation. However, depending on how market participants have applied the CFTC's facts-and-circumstances analysis, they may be able to rely on such representations. Because we are permitting persons to rely on counterparty representations, we do not think it necessary to provide guidance regarding specific factors a person may consider in determining its counterparty's principal place of business, as some commenters requested. Cf. note 221, supra (citing IIB Letter).

260 Cf. note 213, supra (citing IIB letter suggesting that an entity's principal place of business should be the location of its headquarters). Our definition of "principal place of business" is in this respect similar to the guidance issued by the CFTC regarding the application of "principal place of business" to operating companies. See CFTC Cross-Border Guidance, 78 FR at 45309. We expect that outcomes of our final definition of "principal place of business" for such entities would generally be similar to those produced under the CFTC Cross-Border Guidance.

261 See note 216, supra.

States.[262] Moreover, we believe that a definition of "U.S. person" that did not incorporate a "principal place of business" element potentially would result in certain entities falling outside the Title VII regulatory framework, even though the nature of their legal and financial relationships in the United States is, as a general matter, indistinguishable from that of entities incorporated, organized, or established in the United States.[263] Given that such entities raise the types of concerns that Title VII was intended to address, we believe it is both appropriate under our territorial approach and consistent with the purposes of Title VII to treat such entities as U.S.

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[262] For this reason, although we believe that the definition of "principal place of business" set forth in the final rule is consistent with our territorial approach to application of Title VII, we also believe that it is necessary or appropriate to prevent the evasion of Title VII. See Exchange Act section 30(c). The final definition of "principal place of business" will help ensure that entities do not restructure their business by incorporating under foreign law while continuing to direct, control, and coordinate the operations of the entity from within the United States, which would enable them to maintain a significant portion of their financial and legal relationships within the United States while avoiding application of Title VII requirements to such transactions.

[263] In addition, some foreign regulators expressed concerns about our proposed inclusion of a "principal place of business" element in the "U.S. person" definition, see notes 216-217, supra, and one foreign regulator encouraged us to focus our final "U.S. person" definition on where a legal person is established. See note 216, supra. We note that under the European Market Infrastructure Regulation, a foreign fund is treated identically to a European financial counterparty if it is managed by a European investment manager. See Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, CCPs, and trade repositories, Article 2(8) (defining "financial counterparty" to include "an alternative investment fund managed by [alternative investment fund managers] authorised or registered in accordance with Directive 2011/61/EU"). This appears to reflect a recognition that where legal person is established should not be treated as the sole relevant factor in determining whether legal person should be subject to such jurisdiction's rules.

We also note that limiting our definition of "U.S. person" to entities incorporated, established, or organized in the United States as some commenters requested would not eliminate the potential that entities would be simultaneously classified as U.S. persons and as local persons under foreign law. Even under such a definition, some persons could be classified both as U.S. persons for purposes of Title VII and as persons established in foreign jurisdictions under a foreign regulatory regime. Cf. EC Letter. Although we are adopting a definition of "U.S. person" that should mitigate this likelihood, we recognize that such entities may be subject to overlapping regulation, and we intend to address the availability of substituted compliance with respect to specific substantive requirements in subsequent releases, which should mitigate the concerns expressed by these commenters. Cf. note 218, supra (citing ESMA Letter noting possibility of duplicative and conflicting regulation of certain persons as a result of the Commission's inclusion of a principal place of business element in the "U.S. person" definition).

persons for purposes of the final rule.

We also have considered the suggestion by one commenter that "principal place of business" be defined to incorporate certain quantitative thresholds and an exception for firms whose jurisdiction of incorporation has an acceptable regulatory framework in place.[264] However, we do not believe such thresholds are necessary. Because the analysis is applied on an entity-wide basis, consistent with our entity-based approach generally, the "principal place of business" analysis generally will not encompass companies incorporated, organized, or established outside the United States merely because they have an office or branch within the United States. Similarly, we do not believe that the determination whether a legal person's jurisdiction of incorporation, organization, or establishment has an acceptable regulatory framework is relevant to the question whether a specific person has its principal place of business in the United States any more than it would be relevant for a person incorporated within the United States but subject to regulation abroad. The question whether such a company should be permitted to fulfill relevant Title VII requirements by complying with the law of the jurisdiction in which it is incorporated, organized, or established is a separate issue that may be addressed in a separate substituted compliance determination.[265]

Finally, we recognize that one commenter suggested that a "principal place of business" test should look to the location of personnel directing the security-based swap activity of the entity,[266] but we are not convinced that the location of such personnel, without more, would

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[264] See note 217, supra (citing EC Letter); note 216, supra (citing ESMA Letter urging the Commission not to include U.S. branches of foreign banks in its "U.S. person" definition under a "principal place of business" test).

[265] Cf. Cross-Border Proposing Release, 78 FR at 31085-102 (setting forth proposed substituted compliance framework).

[266] See note 206, supra (citing Citadel Letter).

necessarily correspond to the location of a significant portion of the entity's financial and legal relationships, which is the focus of our "U.S. person" definition. We also note that a focus on the location of personnel directing the entity's security-based swap activity would provide an incentive for market participants to move such personnel outside the United States while maintaining their executive offices, and the bulk of their operations, within the United States. Such restructuring would allow an entity to avoid application of Title VII to its security-based swap activities while continuing to maintain a significant portion of its financial and legal relationships within the United States, leaving unchanged the likelihood that risks arising from its security-based swap activity could manifest themselves within the United States while avoiding application of Title VII to such activities.[267]

b. Externally managed investment vehicles

Application of the "principal place of business" test to externally managed investment vehicles presents certain challenges not present when determining the principal place of business of an operating company or other internally managed legal person. For example, an operating company generally will carry out key functions (including directing, controlling, and coordinating its business activities) on its own behalf and generally will have offices through which these functions are performed. Responsibility for key functions of an externally managed investment vehicle, on the other hand, generally will be allocated to one or more separate persons (such as external managers, or other agents), with few or no functions carried out

[267] As noted above, we believe that the definition of "principal place of business" set forth in the final rule is consistent with our territorial approach to application of Title VII. We also note, however, that for the reasons just discussed the final definition's focus on activity of the person as a whole, as opposed to a focus on the security-based swap activity of the person, is in our view necessary or appropriate to prevent the evasion of Title VII. See Exchange Act section 30(c).

through an office of the vehicle itself.[268] Further complicating the application of this definition is the organizational and operational diversity of such vehicles.

Notwithstanding these challenges, we also recognize that externally managed investment vehicle are active participants in the security-based swap market[269] and, in our view, should be treated as U.S. persons if their operations are primarily directed, controlled, and coordinated from a location within the United States. For example, we understand that a significant portion of the investment vehicles that participate in the security-based swap market are private funds such as hedge funds. We have observed that such private funds commonly may be organized under non-U.S. law – frequently in the Cayman Islands – but are managed by investment advisers headquartered in the United States.[270] We also understand that those advisers commonly manage or direct the investment activities of these vehicles, including the arrangement of security-based swaps, through locations within the United States. We further understand that a significant portion of the financial and legal relationships of such vehicles, as a general matter, are in the United States, including some combination of equity ownership by managers (or their affiliates) and outside investors, credit relationships with prime brokers and other lenders, and relationships with other market participants and service providers. These vehicles, therefore, raise concerns that are similar to those raised by the security-based swap

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[268] Such functions may not even be carried out in the jurisdiction in which the externally managed vehicle is incorporated, organized, or established. Indeed, many private investment funds are incorporated, organized, or established under the laws of a jurisdiction with which they have only a nominal connection.

[269] See Tables 1 and 2, supra (noting involvement of investment advisers and private funds in the security-based swap market).

[270] This observation is consistent with data reported to us by private fund managers. See Staff of the Division of Investment Management, U.S. Securities and Exchange Commission, Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports (July 25, 2013) at Appendix A (providing aggregated, non-proprietary data on percentages of reporting private funds organized under non-U.S. law and on locations of advisers to such funds).

activities of market participants that are incorporated, established, or organized in the United States. Over the past two decades, failures of investment vehicles of various types organized under foreign law, but directed, controlled, or coordinated from within the United States have had significant negative impact on U.S. financial institutions, potentially threatening the stability of the U.S. financial system more generally.[271] We believe that it is reasonable to expect that the security-based swap activities of such vehicles may pose similar risks.[272]

To address the unique characteristics of externally managed investment vehicles, we are including in our definition of "principal place of business" language specifying that an externally managed investment vehicle's principal place of business is "the office from which the manager[273] of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle." This definition directs market participants to consider where the activities of an

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271 For example, Long Term Capital Management ("LTCM"), a Delaware partnership with its principal place of business in Connecticut, established a master fund, Long-Term Capital Portfolio, L.P. ("LTCP"), in the Cayman Islands. Mine Aysen Doyran, Financial Crisis Management and the Pursuit of Power: American Pre-Eminience and the Credit Crunch 83-84 (Ashgate 2011). LTCP attracted investments from both U.S. and foreign investors. Id. When it failed in 1998, fourteen domestic and foreign banks and securities firms ("the Consortium") that were major creditors or counterparties of the fund agreed to recapitalize it. GAO, Responses to Questions Concerning Long-Term Capital Management and Related Events 1 n.2, (identifying these fourteen firms); id. at 8-9 (stating that "[t]hese firms contributed about $3.6 billion into [LTCP]") (available at: http://www.gao.gov/archive/2000/gg00067r.pdf). The Federal Reserve Board of New York played a key role in initiating discussion among the banks that ultimately formed the Consortium. Id. at 10.

Other, more recent, examples of risks of such entities established under foreign law manifesting themselves within the United States include the failure of two Bear Stearns hedge funds, which had significant repercussions within the United States, and the bailouts of bank-sponsored structured investment vehicles. See, e.g., FCIC Report at 241, 289-90; Henry Tabe, The Unravelling of Structured Investment Vehicles: How Liquidity Leaked Through SIVs (2010), at 192-94.

272 For these reasons, we are declining to follow the suggestion of one commenter that we not include a principal place of business element of the "U.S. person" definition for investment vehicles. See note 198, supra.

273 Identifying the manager for purposes of this definition will depend on the structure and organizing documents of the investment vehicle under consideration.

externally managed investment vehicle generally are directed, controlled, and coordinated, even if this conduct is performed by one or more legally separate persons.[274] For an investment vehicle, for example, the primary manager is responsible for directing, controlling, and coordinating the overall activity of the vehicle, such that the business of the vehicle, such as its investment and financing activity, is principally carried out at the location of the primary manager. Such an investment vehicle's principal place of business under the final rule would be the location from which the manager carries out those responsibilities.[275]

As noted above, at least one commenter suggested that a "principal place of business" test should look to the location of personnel directing the security-based swap activity of the vehicle.[276] Although we believe that the manager responsible for directing, controlling, and coordinating the activities of the externally managed investment vehicle also would generally be responsible for directing, controlling, and coordinating the security-based swap activity of such vehicle, we do not believe that an externally managed vehicle should be excluded from the U.S. person definition merely because the manager that otherwise directs, controls, and coordinates its

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[274] Exchange Act rule 3a71-3(a)(4)(ii). At least one commenter also recognized that differences between categories of legal persons may require different tests for determining whether a person has its principal place of business in the United States. See IIB Letter at 5-6 (suggesting separate "principal place of business" tests for operating companies and investment vehicles). The CFTC Cross-Border Guidance, which provides separate guidance for operating companies, trusts, and investment vehicles, tailored to the characteristics of each, appears to reflect this distinction. See CFTC Cross-Border Guidance, 78 FR at 45309-311.

[275] As noted above, one commenter suggested that we adopt a definition of "principal place of business" that looked to where the operational management activities of the fund are carried out. Cf. note 200, supra. We are not convinced, however, that the location of such activities (which the commenter identified as including "establishing the fund and selecting its investment manager, broker, and underwriter/placement agent"), absent an ongoing role by the person performing those activities in directing, controlling, and coordinating the investment activities of the fund, generally will be as indicative of activities, financial and legal relationships, and risks within the United States of the type that Title VII as the location of a fund manager.

[276] See note 213, supra (citing Citadel Letter).

activity has effectively shifted responsibility for the security-based swap activity of the externally managed vehicle to a non-U.S. person. As noted above, such an approach would provide an incentive to move responsibility for the security-based swap activity of externally managed vehicles outside the United States while retaining control of all other activities relating to management of such vehicles within the United States. As with the "principal place of business" definition more generally, and for similar reasons, we believe that the definition of "principal place of business" set forth in the final rule with respect to externally managed vehicles is consistent with our territorial approach to application of Title VII. We also note, however, that for the reasons just discussed the final definition's focus on where the activity of the vehicle as a whole is primarily directed, controlled, and coordinated, as opposed to a focus on its security-based swap activity, is in our view necessary or appropriate to prevent the evasion of Title VII.[277]

In our proposal, we stated that we did not think that the U.S.-person status of a commodity pool operator ("CPO") or fund adviser (as opposed to the fund actually entering into the transaction) was in itself relevant in determining the U.S.-person status of an investment vehicle.[278] Although the definition of "principal place of business" we are adopting in this final rule may lead to similar classifications of investment vehicles for purposes of the "U.S. person" definition as a test that looked to the U.S.-person status of a CPO or fund adviser, we believe that the definition we are adopting is more appropriately designed to capture externally managed investment vehicles that raise the kinds of concerns that Title VII was intended to address. Moreover, we note that mere retention of an asset manager that is a U.S. person, without more,

[277] See Exchange Act section 30(c).

[278] See Cross-Border Proposing Release, 78 FR at 31144 n.1454.

would not necessarily bring an offshore investment vehicle or other person within the scope of the "U.S. person" definition.[279] However, where an asset manager, whether or not a U.S. person, is primarily responsible for directing, controlling, and coordinating the activities of an externally managed vehicle and carries out this responsibility within the United States, we believe that it is reasonable to include the externally managed vehicle in the definition of "U.S. person"[280] and to require foreign dealers to include dealing activity with such vehicles in their de minimis threshold calculations.

iii. Fund ownership

Some commenters urged us to include in the definition investment vehicles that are majority-owned by U.S. persons.[281] One of these commenters noted that the CFTC had reasoned that "'passive investment vehicles'" designed to "'achieve the investment objectives of their beneficial owner'" were distinguishable from majority-owned entities that are "'separate, active operating businesses.'"[282] We are not persuaded, however, that this distinction between investment vehicles and operating companies warrants treating ownership interests in these two types of entities differently for purposes of the "U.S. person" definition, particularly given that the exposure of investors in a collective investment vehicle engaging in security-based swap

[279] Cf. note 195, supra (citing IAA letter urging the Commission to follow the CFTC in clarifying that retention of an asset manager that is a U.S. person alone would not bring a person within the scope of the "U.S. person" definition).

[280] We also noted in our proposal that a transaction by an adviser on behalf of a fund could be a "transaction conducted within the United States" as defined in the proposal and thus fall within the scope of Title VII. See Cross-Border Proposing Release, 78 FR at 31144 n.1454. As noted above, we are not addressing the "transaction conducted within the United States" element of our proposal in the final rule and instead intend to address this element of the proposed dealer de minimis threshold calculations in a subsequent reproposal.

[281] See note 203, supra (citing BM Letter and AFR Letter). The CFTC also incorporated a majority-ownership inquiry in its interpretation of "U.S. person" as it applies to funds. See CFTC Cross-Border Guidance, 78 FR at 45313.

[282] BM Letter at 10 (quoting CFTC Cross-Border Guidance, 78 FR at 45314).

transactions typically is capped at the amount of their investment and such investors generally are unlikely to seek to make the investment vehicle's counterparties whole for reputational or other reasons in the event of a default.[283] We do not believe risks created through ownership interests in collective investment vehicles are the types of risks that Title VII is intended to address with respect to security-based swaps.[284]

Because we are not adopting an ownership test for funds, we are also not following the suggestion of some commenters that we exclude from the "U.S. person" definition investment vehicles that are offered publicly only to non-U.S. persons and are not offered to U.S. persons.[285] Although we recognize that the CFTC reasoned that such investment vehicles would generally not be within its interpretation of "U.S. person,"[286] we do not believe that it would be relevant

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[283] See Cross-Border Proposal, 78 FR at 31144 (noting that losses arising from investments in investment vehicles "are generally limited to their investments in the form of equity or debt securities" and that these risks are "addressed by other provisions of U.S. securities law pertaining to issuances and offerings of equity or debt securities").

[284] Several commenters also argued that a majority-ownership test, including any look-through requirements, may be difficult to implement in this context. See note 203, supra (citing ICI Letter and IAA Letter). We believe that our definition of "principal place of business" with respect to externally managed entities should help to ensure that the "U.S. person" definition encompasses investment vehicles that may generally have a significant portion of their financial and legal relationships within the United States and that may therefore raise the types of risk concerns within the United States that Title VII was intended to address.

We note that, because we are not following a majority-ownership approach for collective investment vehicles as part of the "U.S. person" definition, the U.S.-person status of accounts investing in such investment vehicles will not affect the U.S.-person status of such vehicles. Cf. IAA Letter at 4 (explaining that a majority-ownership test would capture non-U.S. funds with minimal nexus to the United States and present implementation challenges).

[285] See note 205, supra (citing IAA Letter). Cf. CFTC Cross-Border Guidance, 78 FR at 45314, 45317. One commenter suggested that the exclusion apply to funds offered publicly only to non-U.S. persons and are regulated in a foreign jurisdiction. See note 205, supra (citing ICI Letter, which suggested that funds regulated under foreign law be excluded from the "U.S. person" definition if they are (1) offered publicly only to non-U.S. persons; (2) offered publicly only to non-U.S. persons but offered privately to U.S. persons; or (3) authorized to offer publicly within the United States. but elect to offer only privately to non-U.S. institutional investors).

[286] See CFTC Cross-Border Guidance, 78 FR at 45314.

under our final definition, which does not focus on an investment vehicle's ownership by U.S. persons.[287]

(c) Accounts

The final definition of "U.S. person" continues to mean "any account (whether discretionary or not) of a U.S. person," irrespective of whether the person at which the account is held or maintained is a U.S. person.[288] As a general matter, we expect that market participants will determine their U.S.-person status under the prongs of that definition relating to natural persons or to legal persons.[289] This "account" prong of the definition is intended to clarify that a person's status for purposes of this rule generally does not differ depending on whether the person enters into security-based swap transactions through an account, or depending on whether the account is held or maintained at a U.S. person or a non-U.S. person intermediary or financial institution.[290]

Consistent with the overall approach to the definition of "U.S. person," our focus under the "account" prong of this definition is on the party that actually bears the risk arising from the

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287 We also note that our guidance regarding the meaning of "principal place of business" is designed to identify, among other entities, investment vehicles that may pose risks to the United States, regardless of where they may be offered.

288 Exchange Act rule 3a71-3(a)(4)(i)(C). Thus, if a partnership, corporation, trust, investment vehicle, or other legal person is a U.S. person, any account of that person is a U.S. person.

289 See Exchange Act rule 3a71-3(a)(4)(i)(A) and (B).

290 As we noted in the Cross-Border Proposing Release, this approach is consistent with the treatment of managed accounts in the context of the major security-based swap participant definition, whereby the swap or security-based swap positions in client accounts managed by asset managers or investment advisers are not attributed to such entities for purposes of the major participant definitions, but rather are attributed to the beneficial owners of such positions based on where the risk associated with those positions ultimately lies. See Intermediary Definitions Adopting Release, 77 FR at 30690.

security-based swap transactions.[291] Accordingly, an account owned solely by one or more U.S. persons is a U.S. person, even if it is held or maintained at a foreign financial institution or other person that is itself not a U.S. person; an account owned solely by one or more non-U.S. persons is not a U.S. person, even if it is held or maintained at a U.S. financial institution or other person that is itself a U.S. person. For purposes of this "account" prong of the "U.S. person" definition, account ownership is evaluated only with respect to direct beneficial owners of the account. Because the status of an account turns on the status of the account's beneficial owners, the status of any nominees of an account is irrelevant in determining whether the account is a U.S. person under the final rule.

Where an account is owned by both U.S. persons and non-U.S. persons, the U.S.-person status of the account, as a general matter, should turn on whether any U.S.-person owner of the account incurs obligations under the security-based swap.[292] Consistent with the approach to

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[291] In other words, the U.S.-person status of an account is relevant under our final rule to the extent that the security-based swap activity is carried out by or through the account. Because our final definition of "U.S. person" does not include investment vehicles that are majority-owned by U.S. persons, the underlying ownership of an investment vehicle that engages in security-based swap activity through an account is not relevant in determining the U.S.-person status of an account. Cf. note 224, supra (citing IAA Letter expressing concern about the relationship between the definition of accounts and treatment of funds).

[292] Two commenters urged us to exclude from the definition of "U.S. person" any account with a de minimis level of ownership by a U.S. person. See note 223, supra (citing letters from IAA and SIFMA/FIA/FSR). We, however, do not believe it would be appropriate to incorporate this concept wholesale into the definition of "U.S. person," as a de minimis level of ownership by a U.S. person in the account does not necessarily indicate that such a U.S. person incurs only a de minimis level of risk or obligations under the security-based swap transactions entered into through the account. For example, the U.S. person may be jointly and severally liable with all of the other account owners for obligations incurred under a security-based swap. We recognize that account ownership may take different forms and that security-based swap transactions may impose risks and obligations on account holders in different ways. The approach we are taking here is intended to take into account the concerns expressed by commenters regarding de minimis U.S.-person interests in such accounts, while also recognizing that security-based swap transactions carried out through such accounts may pose risks to U.S. persons and to the U.S. financial system.

U.S.-person and non-U.S.-person accounts described above, neither the status of the fiduciary or other person managing the account, nor the discretionary or non-discretionary nature of the account, nor the status of the person at which the account is held or maintained are relevant in determining the account's U.S.-person status.

(d) Estates

The final rule incorporates a new prong that expressly includes certain estates within the definition of "U.S. person." Under the final rule any estate of a natural person who was a resident of the United States at the time of death is itself a U.S. person.[293] Our proposed rule did not expressly address estates because we did not believe that they typically engage in security-based swap activity and, to the extent that they do, their U.S.-person status would have been determined under the standard applicable to any legal person under our proposed rule. We received no comments in response to our questions regarding whether we should adopt a final rule that expressly addresses estates or that reflects the CFTC's proposed approach.[294]

We continue to believe that estates are not likely to be significant participants in the security-based swap market, but we also believe that, given the unique characteristics of estates, it is appropriate to include in the "U.S. person" definition an express reference to estates of decedents who were residents of the United States at the time of death. This element of our final definition reflects similar considerations to those that informed our inclusion of natural persons who are residents of the United States within the scope of that definition. We noted above that the security-based swap activity of a natural person who is a resident of the United States raises the types of risks that Title VII is intended to address, given that person's residence status and

[293] See Exchange Act rule 3a71-3(a)(4)(i)(D).

[294] The CFTC subsequently issued an interpretation of "U.S. person" that expressly incorporates estates. See CFTC Cross-Border Guidance, 78 FR at 45314.

likely financial and legal relationships, and we expect that the estate of a natural person who was a resident of the United States at the time of his or her death is likely to operate within the same relationships that warranted subjecting such transactions to Title VII during the life of the decedent.

(e) Certain International Organizations

As under the proposal, the final rule expressly excludes certain international organizations from the definition of U.S. person.[295] This list includes "the [IMF], the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies and pension plans."[296] Although these organizations may have headquarters in the United States, the Commission continues to believe that their status as international organizations warrants excluding them from the definition of "U.S. person."[297]

4. Representations Regarding U.S.-person status

Our proposed definition of "U.S. person" did not expressly provide that parties could rely on representations from their counterparties as to their counterparties' U.S.-person status,

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295 Exchange Act rule 3a71-3(a)(4)(iii).

296 Id. Although three commenters requested that we list all such organizations that are excluded from U.S. persons, see note 226, supra, we do not believe it appropriate to attempt to enumerate an exclusive list of entities that may be eligible for such exclusion.

297 Although three commenters requested that the final rule also exclude "controlled affiliates" of these international organizations from the definition of "U.S. person," see note 229, supra (citing SC Letter, WB/IFC Letter, and IDB Letter), our final rule does not incorporate such an exclusion, as commenters did not provide us with information that leads us to change our view that we should not treat such affiliates' security-based swap or other activities differently from other persons that are incorporated, organized, or established in the United States or have their principal place of business here.

although we did anticipate that parties likely would request such representations.[298] On further consideration, we believe that market participants would benefit from an express provision permitting reliance on such representations.[299] Accordingly, under the final rule, a person need not consider its counterparty to be a U.S. person for purposes of Title VII if that person receives a representation from the counterparty that the counterparty does not satisfy the criteria set forth in Exchange Act rule 3a71-3(a)(4)(i), unless such person knows or has reason to know that the representation is not accurate. For purposes of the final rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.[300]

Expressly permitting market participants to rely on such representations in the "U.S. person" definition should help mitigate challenges that could arise in determining a counterparty's U.S.-person status under the final rule. It permits the party best positioned to make this determination to perform an analysis of its own U.S.-person status and convey, in the

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298 See Cross-Border Proposing Release, 78 FR at 31140.

299 Cf. note 230, supra (citing IIB Letter requesting the Commission to confirm that, as a general matter, a representation is sufficient to fulfill diligence requirements under these rules).

300 See Exchange Act rule 3a71-3(a)(4)(iii). This provision applies to each prong of the "U.S. person" definition, including the principal place of business prong. Cf. note 220, supra. As noted above, we are not providing that persons may rely solely on representations from counterparties that have been developed for purposes of the CFTC's interpretation of U.S. person. However, depending on how market participants have applied the CFTC's general facts-and-circumstances inquiry, they may be able to rely on such representations.

As we noted in the proposal, for purposes of the de minimis threshold, the U.S.-person status of a non-U.S. person's counterparty would be relevant only at the time of a transaction that arises out of the non-U.S. person's dealing activity. See Cross-Border Proposing Release, 78 FR at 30994 n.264. Any change in a counterparty's U.S.-person status after the transaction is executed would not affect the original transaction's treatment for purposes of the de minimis exception, though it would affect the treatment of any subsequent dealing transactions with that counterparty. See also Product Definitions Adopting Release, 77 FR at 48286 ("If the material terms of a Title VII instrument are amended or modified during its life based on an exercise of discretion and not through predetermined criteria or a predetermined self-executing formula, the Commissions view the amended or modified Title VII instrument as a new Title VII instrument").

form of a representation, the results of that analysis to its counterparty. In addition, such representations should help reduce the potential for inconsistent classification and treatment of a person by its counterparties and promote uniform application of Title VII.[301]

The final rule reflects a constructive knowledge standard for reliance. Under this standard, a counterparty is permitted to rely on a representation, unless the person knows or has reason to know that the representation is inaccurate. A person would have reason to know the representation is not accurate for purposes of the final rule if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.[302] We believe that this "know or have reason to know" standard should help ensure that potential security-based swap dealers and major security-based swap participants do not disregard facts that call into question the validity of the representation.

D. Application of De Minimis Exception to Dealing Activities of Conduit Affiliates

1. Proposed Approach and Commenters' Views

The Cross-Border Proposing Release did not include requirements specific to "conduit affiliates" or other non-U.S. persons that enter into security-based swap transactions on behalf of

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301 The final rule permitting reliance on representations with respect to a counterparty's U.S.-person status applies only to the definition of "U.S. person" as used in this final rule and does not apply to any determinations of a person's U.S.-person status under any other provision of the federal securities laws, including Commission rules, regulations, interpretations, or guidance.

302 Cf. IIB Letter at 5 n.9 (urging the Commission to permit reliance on counterparty representations, "absent knowledge of facts that would cause a reasonable person to question the accuracy of the representation"). To the extent that a person has knowledge of facts that would lead a reasonable person to believe that a counterparty may be a U.S. person under the final definitions it may need to conduct additional diligence before relying on the representation.

We recognize that one commenter urged us to limit a reasonable reliance standard for such representations to representations concerning whether a person had its principal place of business in the United States. Cf. note 220, supra (citing ABA Letter). However, we believe that applying a single standard of reliance to all representations regarding a person's U.S.-person status will reduce the potential complexity of establishing policies and procedures associated with identifying the U.S.-person status of counterparties.

their U.S. affiliates. Instead, the proposal would have treated those entities like other non-U.S. persons, and required them to count, against the de minimis thresholds, only their dealing transactions with U.S. persons other than foreign branches, and their dealing transactions conducted in the United States.[303] The proposal also noted that the general rule implementing the de minimis exception excludes transactions between majority-owned affiliates from the analysis.[304]

The proposal acknowledged the difference between its approach and the CFTC's approach in its proposed cross-border guidance, which encompassed special provisions for foreign affiliates that act as conduits for U.S. persons.[305] We thus cited the CFTC's proposed approach toward conduit affiliates in requesting comment regarding whether the Commission should follow a similar approach.[306] We also requested comment as to whether the Commission should, consistent with the CFTC's proposed approach, require a person that operates a "central booking system" – whereby security-based swaps are booked to a single legal person – be subject to applicable dealer registration requirements as if the person had entered into the security-based swaps directly.[307] More generally, we requested comment as to whether foreign affiliates of U.S. persons, such as majority-owned subsidiaries of U.S. parents, should be considered to be U.S. persons.[308]

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303 See proposed Exchange Act rule 3a71-3(b)(1)(ii).

304 See Cross-Border Proposing Release at 31006 (citing Exchange Act rule 3a71-1(d)).

305 See id. at 31006 n.356.

306 See id. at 31024.

307 See id. at 31007.

308 See id. at 30998-99.

One commenter took the view that the Commission's rules should not make use of the conduit affiliate concept notwithstanding its use in the CFTC Cross-Border Guidance, stating that the concept lacks any statutory or regulatory authority, would not advance efforts to reduce systemic risk, and, if applied to end-users, would interfere with internal risk allocations within a corporate group.[309] In contrast, one commenter depicted conduit affiliates as being a type of person that is subject to a de facto guarantee by a U.S. affiliate and that should thus be treated as a U.S. person, and also argued that the dealer registration requirement should apply to other types of entities subject to a de facto guarantee.[310]

One commenter further opposed the adoption of an approach that would require a "central booking system" or any other affiliate to register as a security-based swap dealer based solely on its inter-affiliate security-based swap transactions, arguing that such an approach would tie registration requirements to firms' internal risk management practices, and would hamper the ability to manage risk across a multinational enterprise.[311]

2. Final Rule

The final rule distinguishes "conduit affiliates" from other non-U.S. persons by requiring such entities to count all of their dealing transactions against the de minimis thresholds, regardless of the counterparty.[312] As discussed below, for these purposes a "conduit affiliate" is

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309 See CDEU Letter at 3-5 (adding that if the conduit concept is not rejected, at a minimum it should exclude non-dealers and should not be applied to security-based swaps in which neither party is a dealer or a major participant).

310 See BM Letter at 3, 14-15.

311 See SIFMA/FIA/FSR Letter at A-16 to A-17 (also stating that the final CFTC cross-border guidance does not include the central booking system concept). See also CDEU Letter at 3-5 (raising concerns that the regulation of conduit affiliates may have the potential to interfere with the use of centralized treasury units that corporate groups may use as a market-facing entity for a non-dealer's corporate group).

312 See Exchange Act rule 3a71-3(b)(1)(ii).

a non-U.S. affiliate of a U.S. person that enters into security-based swaps with non-U.S. persons, or with certain foreign branches of U.S. banks, on behalf of one or more of its U.S. affiliates (other than U.S. affiliates that are registered as security-based swap dealers or major security-based swap participants), and enters into offsetting transactions with its U.S. affiliates to transfer the risks and benefits of those security-based swaps.

After careful consideration, we believe that requiring such conduit affiliates to count their dealing transactions against the de minimis thresholds is appropriate to help ensure that non-U.S. persons do not facilitate the evasion of registration requirements under Dodd-Frank by participating in arrangements whereby a non-U.S. person engages in security-based swap activity outside the United States on behalf of a U.S. affiliate that is not a registered security-based swap dealer or major security-based swap participant,[313] and the U.S. affiliate assumes economic risks and benefits of those positions by entering into offsetting transactions with the non-U.S. affiliate. Absent such a requirement that conduit affiliates count their dealing transactions for purposes of the de minimis exception, a U.S. person may be able to effectively engage in unregistered dealing activity involving non-U.S. persons by having a non-U.S. affiliate enter into dealing transactions with other non-U.S. persons (which would not be counted against the de minimis thresholds because both counterparties are non-U.S. persons) or with foreign branches of U.S. banks that are registered as security-based swap dealers (which would not be counted against the de minimis thresholds because of an exclusion for dealing transactions with foreign branches of U.S. banks that are registered as security-based swap dealers). The U.S. person could enter into

313 As discussed below, the "conduit affiliate" definition does not encompass persons that engage in such offsetting transactions solely with U.S. persons that are registered with the Commission as security-based swap dealers or major security-based swap participants because we do not believe that such transactions raise the types of evasion concerns that the conduit affiliate concept is designed to address.

offsetting transactions with those non-U.S. affiliates, and those offsetting transactions would not be counted against the de minimis thresholds due to the inter-affiliate exception to the dealer analysis.[314]

Accordingly, in our view, requiring conduit affiliates to count their dealing transactions against the thresholds is necessary or appropriate to prevent the evasion of any provision of the amendments made to the Exchange Act by Title VII for the reasons given above.[315] We believe that this requirement is appropriately tailored to prevent the evasion of the dealer requirements,[316] while preserving participants' flexibility in managing risk exposures through inter-affiliate transactions.[317]

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314 The rule requires that a conduit affiliate count all of its dealing activity, and is not limited to the conduit affiliate's dealing transactions that specifically are linked to offsetting transactions with a U.S. affiliate. This is because there may not be a one-to-one correspondence between dealing transactions and their offsets for reasons such as netting.

315 See Exchange Act section 30(c); section II.B.2(d), supra. In noting that this requirement is consistent with our anti-evasion authority under Exchange Act section 30(c), we are not taking a position as to whether such activity by a conduit affiliate otherwise constitutes a "business in security-based swaps without the jurisdiction of the United States."

316 We recognize that not all dealing structures involving conduit affiliates may be evasive in purpose. We believe, however, that the anti-evasion authority of section 30(c) permits us to prescribe prophylactic rules to conduct without the jurisdiction of the United States, even if those rules would also apply to a market participant that has been transacting business through a pre-existing market structure established for valid business purposes, so long as the rule is designed to prevent possible evasive conduct. See Cross-Border Proposing Release, 78 FR at 30987; see also section II.B.2(d), supra (discussion of anti-evasion authority); Abramski v. United States, No. 12-1493, slip op. at 14 (S. Ct. June 16, 2014) (noting "courts' standard practice, evident in many legal spheres and presumably known to Congress, of ignoring artifice when identifying the parties to a transaction").

We also note that while this requirement appears consistent with the views of a commenter that supported the use of the conduit affiliate concept, we take no position on that commenter's view that conduit affiliates represent a type of entity that is subject to a de facto guarantee by a U.S. person. See note 310, supra. Indeed, in our view the conduit affiliate concept will serve as a useful anti-evasion tool even in the situation where the conduit affiliate's counterparty does not consider the U.S. person's creditworthiness in determining whether to enter into a security-based swap with the conduit affiliate.

317 For example, one potential alternative anti-evasion safeguard could be to narrow the inter-affiliate exception to counting dealing transactions against the de minimis thresholds, such as by making

In light of the anti-evasion rationale for this use of the conduit affiliate concept, which is consistent with our statutory anti-evasion authority, we are not persuaded by a commenter's view that the use of the concept is outside of our authority.[318] We also are not persuaded by that commenter's suggestion that the use of the conduit affiliate concept would not advance risk-mitigation goals, given that the concept can be expected to help ensure that the provisions of Title VII applicable to dealers (including risk mitigation provisions such as margin and capital requirements) are implemented, which can be expected to produce risk mitigation benefits.

At the same time, we recognize the significance of commenter concerns that the use of the "conduit affiliate" concept or the use of a "central booking system" approach to registration could impede efficient risk management practices.[319] The conduit affiliate concept serves as a prophylactic anti-evasion measure, and we do not believe that any entities currently act as conduit affiliates in the security-based swap market, particularly given that a framework for the comprehensive regulation of security-based swaps did not exist prior to the enactment of Title VII, suggesting that market participants would have had no incentives to use such arrangements for evasive purposes.

Moreover, in light of this anti-evasion purpose, the definition of "conduit affiliate" does not include entities that may otherwise engage in relevant activity on behalf of affiliated U.S. persons that are registered with the Commission as security-based swap dealers or major

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the exception unavailable in the context of transactions between non-U.S. persons and their U.S. affiliates. We believe, however, that such an approach would be less well-targeted than the use of the conduit affiliate concept, as that alternative could impact a corporate group's ability to use specific market-facing entities to facilitate the group's security-based swap activities (given that the market-facing entities would arguably be acting as a dealer on behalf of its affiliates).

[318] See CDEU Letter at 3 ("The concept of a conduit affiliate is not based on statutory or regulatory authority, and does not decrease the potential for systemic risk."). See also note 309, supra.

[319] See note 311, supra (citing CDEU Letter).

security-based swap participants, as we do not believe that transactions involving these types of registered entities and their foreign affiliates raise the types of evasion concerns that the conduit affiliate concept is designed to address.[320]

In addition, in the context of the dealer de minimis exception, the relevant rules would require the conduit affiliate to count only its dealing transactions. The rules accordingly distinguish dealing activity by a conduit affiliate from a corporate group's use of affiliates for non-dealing purposes, such as a corporate group's use of a single affiliated person to enter into transactions with the market for risk management not involving dealing activity (accompanied by offsetting inter-affiliate transactions that place the economic substance of the instrument into another person within the group). The requirement we are adopting here – under which a conduit affiliate will count only its dealing transactions against the de minimis thresholds – is not expected to impact persons that enter into security-based swaps with affiliates for non-dealing purposes.[321]

Consistent with these goals, the final rule defines "conduit affiliate" in part as a non-U.S. person that directly or indirectly is majority-owned by one or more U.S. persons.[322] To be a

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320 As discussed below, we also are applying the conduit affiliate concept to the major participant analysis to help guard against evasive practices. See section V.C, infra.

321 One commenter particularly suggested that the conduit affiliate concept, if implemented, should exclude non-dealers. See CDEU Letter. As the requirement related to counting by conduit affiliates for purposes of the de minimis dealer exception is relevant only to the extent that a conduit affiliate engages in dealing activity, however, we do not believe that it is necessary to otherwise tailor the requirement to address the possibility that a conduit affiliate is acting on behalf of an affiliated U.S. non-dealer for risk management or other non-dealing purposes.

Moreover, as discussed above, over a recent six-year period, entities that are recognized as dealers are responsible for almost 85 percent of transactions involving single-name CDS. See Table 1, section III.A.1, supra.

322 See Exchange Act rule 3a71-3(a)(1)(i)(A).

For purposes of the definition, the majority-ownership standard is met if one or more U.S. persons directly or indirectly own a majority interest in the non-U.S. person, where "majority

conduit affiliate, moreover, such a person must in the regular course of business enter into in security-based swaps with one or more other non-U.S. persons or with foreign branches of U.S. banks that are registered as security-based swap dealers,[323] for the purposes of hedging or mitigating risks faced by, or otherwise taking positions on behalf of, one or more U.S. persons[324] (other than U.S. persons that are registered as security-based swap dealers or major security-based swap participants) that control, are controlled by, or are under common control with the potential conduit affiliate, and enter into offsetting security-based swaps or other arrangements with such affiliated U.S. persons to transfer risks and benefits of those security-based swaps.[325]

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interest" is the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership. See Exchange Act rule 3a71-3(a)(1)(ii). This parallels the majority-ownership standard in the inter-affiliate exclusion from the dealer analysis. See Exchange Act rule 3a71-1(d).

323 The definition does not require a conduit affiliate to exclusively transact with such non-U.S. persons and foreign branches. Accordingly, transactions with other types of U.S. persons would not cause a person to fall outside the "conduit affiliate' definition.

324 For these purposes, it would not be necessary that the non-U.S. person transfer the risks and benefits of all of its security-based swaps. It also would not be necessary that the non-U.S. person transfer all of the risks and benefits of any particular security-based swap; for example, the non-U.S. person may retain the credit risk associated with a security-based swap with a non-U.S. counterparty, but transfer to its U.S. affiliate the market risk associated with the instrument.

325 See Exchange Act rule 3a71-3(a)(1)(i)(B).

The reference to "other arrangements" to transfer the risks and benefits of security-based swaps, as an alternative to entering into offsetting security-based swaps, may encompass, for example, the use of swaps to transfer risks and benefits of the security-based swaps (for example, two CDS based on slightly different indices of securities could be used to approximately replicate a security-based swap such as a CDS based on a single reference entity).

We note that while the CFTC Cross-Border Guidance also states the view that as a general matter conduit affiliates should count their dealing activity against the de minimis thresholds (see 78 FR at 45318-19), the CFTC's interpretation of what constitutes a "conduit affiliate" differs in certain ways from our final rule. For example, the CFTC's approach takes into account whether the conduit affiliate's financial results are consolidated in the U.S. person's financial statements, and the CFTC states that it did not "intend that the term 'conduit affiliate' would include affiliates of swap dealers." See CFTC Cross-Border Guidance, 78 FR at 45359; see also id. at 45318-19 n.258.

E. Application of De Minimis Exception to Dealing Activities of Other Non-U.S. Persons

As noted above, the proposal would have required non-U.S. persons to count, against the de minimis thresholds, only their dealing transactions involving U.S. persons other than foreign branches, and their dealing transactions conducted within the United States.[326]

Aside from issues related to conduit affiliates, addressed above, commenters discussed other issues regarding the application of the de minimis exception to the dealing activities of non-U.S. persons, particularly relating to: (i) dealing transactions of non-U.S. persons that are guaranteed by their U.S. affiliates; (ii) activities within the United States; and (iii) dealing activities of other non-U.S. persons whose counterparties are U.S. persons (including foreign branches of U.S. banks) or non-U.S. persons guaranteed by U.S. persons. We are addressing those groups of issues separately, given the distinct issues relevant to each.[327] As discussed below, the final rule requires non-U.S. persons (apart from the conduit affiliates addressed above) to count all of their dealing transactions where: (1) the transaction is subject to a recourse guarantee against a U.S. affiliate of the non-U.S. person; or (2) the counterparty to the transaction is a U.S. person, other than the foreign branch of a registered security-based swap dealer.

In our view, the final rule's definition – including its prerequisite that the conduit affiliate be majority-owned by non-natural U.S. persons appropriately focuses the meaning of the term "conduit affiliate" on persons who may engage in security-based swap activity on behalf of U.S. affiliates in connection with dealing activity (and, as discussed below, see section V.C, infra, in connection with other security-based swap activity in the context of the major participant definition).

326 See proposed Exchange Act rule 3a71-3(b)(1)(ii).

327 In addition, some commenters requested an exclusion for transactions that are executed anonymously and cleared. Those comments – and our incorporation of an exception for certain cleared anonymous transactions – are addressed below. See section IV.G, infra.

1. Dealing Transactions of Non-U.S. Persons that are Subject to Recourse Guarantees by their U.S. Affiliates

(a) Proposed Approach and Commenters' Views

Under the proposal, a non-U.S. person's transactions involving security-based swaps guaranteed by its U.S. affiliate would have been treated the same as other transactions of non-U.S. persons for purposes of the de minimis exception. In other words, the non-U.S. guaranteed affiliate would have counted, against the de minimis thresholds, only its dealing transactions involving U.S. persons other than foreign branches, and its dealing transactions otherwise conducted within the United States.[328]

In the Cross-Border Proposing Release, we solicited comment regarding whether the "U.S. person" definition should incorporate foreign entities that are guaranteed by their U.S. affiliates.[329] We also expressed the preliminary view that the primary risk related to such guaranteed transactions of non-U.S. persons was the risk posed to the United States via the guarantee from a U.S. person, rather than the dealing activity occurring between two non-U.S. persons outside the United States, and sought to address this risk via the proposed attribution principles in the "major security-based swap participant" definition, and we also expressed the view that the use of the major participant definition effectively would address those regulatory concerns.[330]

[328] See proposed Exchange Act rule 3a71-3(b)(1)(ii).

[329] See Cross-Border Proposing Release, 78 FR at 30998.

[330] See id. at 31006. As part of the proposal, we also expressed the preliminary view that dealer regulation of such persons would not materially increase the programmatic benefits of the dealer registration requirement, and that such an approach would impose programmatic costs without a corresponding increase in programmatic benefits to the U.S. security-based swap market. See id. at 31146-47. For the reasons discussed below, however, we have concluded that it is appropriate to require non-U.S. guaranteed affiliates of U.S. persons to count, against the de minimis thresholds, their dealing transactions that are subject to a right of recourse against a U.S. person. See IV.E.1(b) (discussing the final rule's changes to the preliminary view).

Two commenters supported an alternative approach to require such guaranteed non-U.S. persons to count all of their dealing transactions against the thresholds. One commenter stated that non-U.S. persons that receive guarantees from U.S. persons should count all of their dealing transactions toward the de minimis thresholds, arguing that the failure to do so would be inconsistent with the resulting flow of risk to the United States and that major participant regulation was not the appropriate means of addressing those risks.[331] Another commenter took the position that the proposed approach would provide a loophole whereby U.S. entities trading in security-based swaps could avoid regulation under the Dodd-Frank Act.[332] Both commenters further suggested that affiliates of U.S. persons be presumed to be beneficiaries of guarantees,[333] with the presumption potentially subject to rebuttal if there is notice that no guarantee would be provided.[334]

One comment letter did not explicitly address this issue, but did support the Commission's proposed approach not to require non-U.S. persons to aggregate the dealing transactions of their U.S.-guaranteed affiliates against the de minimis thresholds, stating that this would pose too tenuous a nexus with the U.S. to justify registration.[335]

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331 See BM Letter at 17-18.

332 See AFR Letter I at 7-8, 14.

333 See id. at 14 ("In cases where a guarantee is implicit, the use of a rebuttable presumption of a guarantee will put the burden on the foreign affiliate in question to demonstrate to regulators that it is not guaranteed."); BM Letter at 14 (suggesting in part that support should be presumed if a foreign affiliate incorporates a "de facto guarantor's name in its own").

334 See AFR Letter I at 7 ("This presumption could be rebutted by showing clear evidence that counterparties were informed of the absence of a guarantee."); BM Letter at 14-15 (suggesting that presumptions of support might be rebutted by explicit statements within trade documentation accompanied by explicit counterparty waivers, and discussing the potential additional use of associated public filing requirements and of possible "ring-fence" systems for determining which affiliates should be considered U.S persons).

335 See SIFMA/FIA/FSR Letter at A-17.

(b) Final Rule

Under the final rule, a non-U.S. person (other than a conduit affiliate, as discussed above) must count, against the de minimis thresholds, any security-based swap transaction connected with its dealing activity for which, in connection with that particular security-based swap, the counterparty to the security-based swap has rights of recourse against a U.S. person that is controlling, controlled by, or under common control with the non-U.S. person.[336] For these purposes, the counterparty would be deemed to have a right of recourse against a U.S. affiliate of the non-U.S. person if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. affiliate in connection with the non-U.S. person's obligations under the security-based swap.

We understand that such rights may arise in a variety of contexts. For example, a counterparty would have such a right of recourse against the U.S. person if the applicable arrangement provides the counterparty the legally enforceable right to demand payment from the U.S. person in connection with the security-based swap, without conditioning that right upon the non-U.S. person's non-performance or requiring that the counterparty first make a demand on the non-U.S. person. A counterparty also would have such a right of recourse if the counterparty itself could exercise legally enforceable rights of collection against the U.S. person in connection with the security-based swap, even when such rights are conditioned upon the non-U.S. person's insolvency or failure to meet its obligations under the security-based swap, and/or are

[336] See Exchange Act rule 3a71-3(b)(1)(iii)(B). Consistent with the rule generally requiring a person to consider its affiliates' dealing activities for purposes of the de minimis exception (Exchange Act rule 3a71-2(a)(1)), the Commission interprets control to mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise. See Intermediary Definitions Adopting Release, 77 FR at 30631 n.437.

conditioned upon the counterparty first being required to take legal action against the non-U.S. person to enforce its rights of collection.

The terms of the guarantee need not necessarily be included within the security-based swap documentation or even otherwise reduced to writing (so long as legally enforceable rights are created under the laws of the relevant jurisdiction); for instance, such rights of recourse would arise when the counterparty, as a matter of law in the relevant jurisdiction, would have rights to payment and/or collection that may arise in connection with the non-U.S. person's obligations under the security-based swap that are enforceable.[337] We would view the transactions of a non-U.S. person as subject to a recourse guarantee if at least one U.S. person (either individually or jointly and severally with others) bears unlimited responsibility for the non-U.S. person's obligations, including the non-U.S. person's obligations to security-based swap counterparties. Such arrangements may include those associated with foreign unlimited companies or unlimited liability companies with at least one U.S.-person member or shareholder, general partnerships with at least one U.S.-person general partner, or entities formed under similar arrangements such that at least one U.S. persons bears unlimited responsibility for the non-U.S. person's liabilities. In our view, the nature of the legal arrangement between the U.S. person and the non-U.S. person – which makes the U.S. person responsible for the obligations of the non-U.S. person – is appropriately characterized as a recourse guarantee, absent countervailing factors. More generally, a recourse guarantee is present if, in connection with the

[337] For purposes of the dealer de minimis exception, rights of recourse would not be present if legally enforceable rights were to arise by operation of law following the transaction, such as due to later actions that evidence the disregard of corporate form by a party to the transaction and its affiliate. Rights of recourse, in contrast, would encompass rights existing at the time of the transaction but conditioned upon the non-U.S. person's insolvency or failure to meet its obligations under the security-based swap or conditioned upon the counterparty first being required to take legal action against the non-U.S. person to enforce its right of collection.

security-based swap, the counterparty itself has a legally enforceable right to payment or collection from the U.S. person, regardless of the form of the arrangement that provides such a legally enforceable right to payment or collection.

Accordingly, the final rule clarifies that for these purposes a counterparty would have rights of recourse against the U.S. person "if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap."[338]

In revising the proposal, we have been influenced by commenter concerns that the proposed approach could allow non-U.S. persons to conduct a dealing business involving security-based swaps that are guaranteed by a U.S. affiliate without being regulated as a dealer, even though the guarantee exposes the U.S. person guarantor to risk in connection with the dealing activity.[339]

This final rule also reflects our conclusion that a non-U.S. person – to the extent it engages in dealing activity involving security-based swaps subject to a recourse guarantee by its U.S. affiliate – engages in dealing activity that occurs, at least in part, within the United States.

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338 See Exchange Act rule 3a71-3(b)(1)(B). This approach of looking to the presence of rights of recourse to identify guarantees is consistent with our prior views in connection with Title VII implementation. See generally Intermediary Definitions Adopting Release, 77 FR at 30689 (stating that in connection with the application of the major participant definition, "positions in general would be attributed to a parent, other affiliate or guarantor for purposes of the major participant analysis to the extent that the counterparties to those positions would have recourse to that other entity in connection with the position"); Cross-Border Proposing Release, 78 FR at 30977 (noting that a guarantee would typically give the counterparties to a U.S. non-bank dealer direct recourse to a holding company, as though the guarantor had entered into the transactions directly).

339 See BM Letter at 12, 17-18 (stating that the "proposed exemption has the potential to create a large loophole for foreign market participants, while leaving the risk with the American taxpayer," also stating that "de facto guaranteed affiliates" should be classified as U.S. persons "under the SEC's territorial or anti-evasion authority"); AFR Letter I at 5 (suggesting that the proposed treatment of U.S.-guaranteed affiliates, as well as certain other aspects of the proposal, could result in regulatory arbitrage).

As discussed above, the economic reality is that by virtue of the guarantee the non-U.S. person effectively acts together with its U.S. affiliate to engage in the dealing activity that results in the transactions, and the non-U.S. person's dealing activity cannot reasonably be isolated from the U.S. person's activity in providing the guarantee. The U.S. person guarantor together with the non-U.S. person whose dealing activity it guarantees jointly may seek to profit by providing liquidity and otherwise engaging in dealing activity in security-based swaps, and it is the U.S. guarantor's financial resources that enable the guarantor to help its affiliate provide liquidity and otherwise engage in dealing activity. It is reasonable to assume that the counterparties of the non-U.S. person whose dealing activity is guaranteed look to both the non-U.S. person and the U.S. guarantor for performance on the security-based swap. Moreover, the U.S. guarantor bears risks arising from any security-based swap between the non-U.S. person whose dealing activity it guarantees and that affiliate's counterparties, wherever located.

This approach is consistent with the purposes of Title VII. The exposure of the U.S. guarantor creates risk to U.S. persons and potentially to the U.S. financial system via the guarantor to a comparable degree as if that U.S. person had directly entered into the transactions that constituted dealing activity by the affiliate. In many cases the counterparty to the non-U.S. person whose dealing activity is guaranteed may not enter into the transaction with that non-U.S. person, or may not do so on the same terms, absent the guarantee. The U.S. guarantor usually undertakes obligations with respect to the security-based swap regardless of whether that non-U.S. person ultimately defaults in connection with the security-based swap.[340]

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340 We understand that, in practice, a guarantor's obligation to a derivatives counterparty of a person whose security-based swap activity is guaranteed may be based on the same terms as that of the guaranteed person, and that the guarantor's obligation to make payments under the contract may not be contingent upon the guaranteed person's default. Moreover, we understand that margin payments under a contract at times may be made directly by a U.S. guarantor to the counterparty

In requiring non-U.S. persons whose dealing involves security-based swaps that are guaranteed by a U.S. person to apply those dealing transactions against the de minimis thresholds, the final rule further reflects the fact that the economic reality of an offshore dealing business using such non-U.S. persons may be similar or identical to an offshore dealing business carried out through a foreign branch. In both cases the risk of the dealing activity has directly been placed into the United States, and non-U.S. counterparties generally may be expected to look to a U.S. person's creditworthiness in deciding whether to enter into the transaction with the guarantor's non-U.S. affiliate or the foreign branch (and on what terms). The final rule thus should help apply dealer regulation in similar ways to differing organizational structures that serve similar economic purposes, and help avoid disparities in applying dealer regulation to differing arrangements that pose similar risks to the United States.[341]

We believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, U.S. persons may have a strong incentive to evade dealer regulation under Title VII simply by conducting their dealing activity via a guaranteed affiliate, while the economic reality of transactions arising from that activity – including the risks these transactions introduce to the U.S. market – would be no different in most respects than

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of the guaranteed person, particularly when the corporate group uses a consolidated back office located within a parent guarantor, or when the derivative is denominated in U.S. dollars. We further understand that a counterparty may, for risk management purposes, use a single credit limit for all transactions guaranteed by a parent, regardless of which particular affiliate may be used for booking the transaction with that counterparty.

341 For the above reasons, we conclude that this final rule is not being applied to persons who are "transact[ing] a business in security-based swaps without the jurisdiction of the United States," within the meaning of Exchange Act section 30(c). See section II.B.2(a), supra.

transactions directly entered into by U.S. persons. In other words, for example, if a U.S. entity engaged in security-based swap dealing wanted to either avoid registration or otherwise have its security-based swap transactions with foreign counterparties be outside the various Title VII requirements with respect to those transactions, it could establish an overseas affiliate and simply extend a payment guarantee. The purpose for doing so would be to evade the requirements of Title VII and the incentives to do so could be high, making it necessary and appropriate to invoke our Title VII authority, because the economic reality of these transactions would be no different in most respects, including the risks these transactions could introduce to the U.S. market. Arrangements between a U.S. person and a non-U.S. person that, as a matter of law in the relevant jurisdiction, make the U.S. person responsible for the non-U.S. person's liabilities may create similarly strong incentives to restructure business operations to avoid the application of Title VII by providing the economic equivalent of an express guarantee through an arrangement that under relevant law provides the non-U.S. person counterparty with direct recourse against the U.S. person. For these reasons, we believe that it is necessary and appropriate to adopt this rule pursuant to our anti-evasion authority under Exchange Act section 30(c).[342]

Compared to the proposal, this approach also more fully accounts for differences between the regulatory regimes applicable to security-based swap dealers and major security-based swap participants. The definition of "major security-based swap participant" focuses on systemic risk issues, in that it particularly targets persons that maintain "substantial positions" that are

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342 Exchange Act section 30(c) particularly provides that "[n]o provision of [Title VII] . . . shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States," unless that business is transacted in contravention of rules prescribed to prevent evasion of Title VII.

"systemically important," or that pose "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets."[343] The thresholds associated with the major participant definition reflect that systemic risk focus.[344] The dealer definition, in contrast, is activity-focused, addresses the significance of a person's dealing activity only via the de minimis exception, and addresses regulatory interests apart from risk.[345] Accordingly, upon further consideration, we believe that availability of major participant regulation does not mitigate the above considerations regarding risk and regulatory treatment of similar business models, and those considerations are better addressed by counting dealing activities guaranteed by U.S. affiliates against the de minimis thresholds of the non-U.S. persons whose transactions are subject to the guarantees.[346]

In adopting these provisions, we acknowledge that the final rule does not go as far as some commenters have requested, in that it does not require a non-U.S. person to count its dealing transactions involving security-based swaps that do not grant its counterparty a recourse guarantee against the U.S. affiliate of that non-U.S. person, even if the U.S. affiliate is subject to a recourse guarantee with respect to other security-based swaps of the same non-U.S. person. The final rule also does not incorporate the suggestion from certain commenters that we should treat U.S. entities and their affiliates as equivalent for purposes of the cross-border

[343] See Exchange Act section 3(a)(67).

[344] For example, for cleared security-based CDS, a person would have to write $200 billion notional of CDS protection to meet the relevant $2 billion "potential future exposure" threshold that is used as part of the major participant analysis. See Intermediary Definitions Adopting Release, 77 FR at 30671 n.914.

[345] See id. at 30629 ("The statutory requirements that apply to swap dealers and security-based swap dealers include requirements aimed at the protection of customers and counterparties, . . . as well as requirements aimed at helping to promote effective operations and transparency of the swap and security-based swap markets."; footnotes omitted).

[346] This is consistent with the view of one commenter that highlighted the differences in purpose between dealer and major participant regulation. See BM Letter.

implementation of Title VII.[347] The final rule further does not incorporate the suggestion that affiliates of a U.S. person should be presumed to be recipients of de facto guarantees, which could be rebutted via disclosure.[348]

Those commenters raise important concerns regarding the possibility that, even absent explicit financial support arrangements, U.S. entities that are affiliated with non-U.S. persons for reputational reasons may determine that they must support their non-U.S. affiliates at times of crisis. In those commenters' view, such considerations impose risks upon U.S. markets even absent explicit legal obligations. As a result, the commenters suggest that foreign affiliates of U.S. entities should have to count all their dealing transactions against the de minimis thresholds, or that such foreign affiliates should be deemed to be "U.S. persons" for purposes of Title VII.[349]

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[347] See id. at 14, 17-18 ("Thus, regardless of whether an affiliate is 'guaranteed' by a U.S. person, that affiliate may be effectively guaranteed, having the same connection with and posing the same risks to the United States."). See also AFR Letter I at 7-8.

[348] See notes 333 and 334, supra and accompanying text. We note that any U.S. person that is subject to the reporting requirements of section 13(a) or section 15(d) of the Exchange Act, 15 U.S.C. 78m(a) or 15 U.S.C. 78o(d) respectively, regardless of whether that person provides a recourse guarantee relating to its non-U.S. affiliates' obligations, must consider whether there are disclosures that must be made in its periodic reports regarding any of its obligations. These disclosures would include any known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on the financial condition or operating performance of the U.S. person that would be required to be disclosed pursuant to Item 303 of Regulation S-K. As required by Item 303 of Regulation S-K, the disclosures are presented with regard to the registrant (the U.S. person) and its subsidiaries on a consolidated basis. See Item 303 of Regulation S-K, 17 CFR 229.303, and Commission's Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350 (Dec. 19, 2003), 68 FR 75056 (Dec. 29, 2003). See also Item 305 of Regulation S-K, 17 CFR 229.305.

[349] See AFR Letter I at 7 (stating that "[b]oth explicit and implicit guarantees of support from the parent institution should be counted," with a rebuttable presumption that a subsidiary of a U.S. entity is guaranteed, and that "[s]hould the SEC not include guaranteed affiliates and subsidiaries in the definition of 'U.S. person', at the very least SBS with such entities should count toward entities de minimis calculation"); BM Letter at 12, 17 (stating that guaranteed affiliate should be defined "to include those affiliates that are de factor guaranteed, even though not explicitly subject to a guarantee agreement," and that transactions with non-U.S. persons that receive guarantees from U.S. persons should be included in the de minimis calculation).

Our modification requiring these non-U.S. persons to count certain of their dealing transactions with non-U.S. persons against the de minimis thresholds partially addresses those commenter concerns.[350] We also recognize that there may be circumstances in which a U.S. person provides its foreign affiliate with non-recourse support that is not specifically linked to particular instruments or to derivatives activities generally. Our final rule, however, targets recourse-based arrangements whereby the counterparties to the non-U.S. affiliate would be particularly likely to look to the U.S. person for satisfaction of some or all of the obligations arising under the security-based swap. On balance, we believe that an approach that focuses on the presence of recourse arrangements appropriately addresses dealing activities that have a particularly direct effect on the U.S. market, as well as the ability of a U.S. person to use such guarantees to conduct a security-based swap dealing business as an alternative to using a foreign branch.

This is not to say that more general financial support arrangements do not also pose risks to U.S. persons and potentially to the U.S. financial system, including risks posed by the activity of non-U.S. persons to their U.S. parents or affiliates. However, we believe that this focus on recourse guarantees appropriately addresses the most direct risks posed by such guarantee arrangements to U.S. persons and potentially to the U.S. financial system. We also note that Congress has provided additional regulatory tools apart from Title VII to address such risks. Indeed, in enacting the Dodd-Frank Act, Congress provided general tools – not merely tools focusing on derivatives activities – to address the risks associated with U.S.-based financial

[350] This final rule regarding the de minimis exception does not encompass non-U.S. persons who receive a guarantee from an unaffiliated U.S. person. We do not expect that U.S. persons would use guarantees of unaffiliated persons as a substitute for dealing activity via a foreign branch, and we do not believe such arrangements comprise a significant part of dealing activity in the market. Our final rules do, however, generally require such non-affiliate arrangements to be included in the major security-based swap participant threshold calculations. See section V.D.3, infra.

groups as a whole, including the risks posed by such groups' non-guaranteed foreign affiliates engaged in financial services business. This holistic approach to risks that could flow back to the United States may reflect the fact that financial services activities apart from security-based swaps constitute the great majority of such groups' overall financial activities outside the United States that can produce such risks. The regulatory tools substantially enhanced by the Dodd-Frank Act to better address these cross-border risks posed by financial services activities other than security-based swaps and such tools include globally consolidated capital requirements (including enhanced capital and leverage standards, group-wide single-counterparty credit limits, and capital surcharges for firms with particularly high levels of risk), and globally consolidated liquidity and risk management standards (including stress testing, debt-to-equity limitations, living will requirement, and timely remediation measures). By accounting for risks at the consolidated level, these tools address risks posed by guaranteed and non-guaranteed subsidiaries within U.S.-based financial groups, regardless of whether the subsidiaries are based in the United States or outside the United States.[351] Our focus on recourse guarantees appropriately targets the

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[351] See, e.g., Pub. L. No. 111-203, sections 165-166 of the Dodd Frank Act, 124 Stat. 1376, 1423-32 (2010). In the Cross-Border Proposing Release, in connection with our preliminary view that the risks posed by guarantees could be adequately addressed via the regulation of major security-based swap participants, we referenced the Bank Holding Company Act of 1956, and the provisions of Title I of the Dodd-Frank Act regarding the regulation of certain nonbank financial companies and bank holding companies that pose a threat to the financial stability of the United States. See Cross-Border Proposing Release, 78 FR at 31006 n.360.

For the reasons discussed above, however, we have concluded that the presence of those particular regulatory safeguards do not warrant the conclusion that non-U.S. guaranteed affiliates of U.S. persons should not have to count, against the de minimis thresholds, their dealing activity involving other non-U.S. persons when the transaction is subject to a right of recourse against the U.S. affiliate. Although those provisions encompass regulatory safeguards that can be expected to address the risks associated with U.S.-based financial groups, upon further consideration we conclude that it is appropriate for the application of the de minimis test to directly account for those specific security-based swap transactions that are subject to recourse guarantees, as opposed to more generalized risks arising from the range of activities conducted by non-guaranteed foreign affiliates, given the U.S. person's participation in the security-based swap transaction through the guarantee.

concerns raised by security-based swap activity that Title VII was intended to address, recognizing that Congress has established other regulatory tools that are specifically intended, and better suited, to address risks to bank holding companies and financial holding companies, arising from the financial services activities of a foreign affiliate of those holding companies where the foreign affiliate does not engage in security-based swap activity in the United States.

Conversely, one commenter implicitly appeared to oppose any requirement that non-U.S. persons count their guaranteed transactions carried out in a dealing capacity with non-U.S. person counterparties against their de minimis thresholds.[352] For the reasons discussed above, however, we believe that the targeted counting required by the final rule is appropriate to reflect activity involving security-based swaps that occurs in the United States and presents risks to U.S. persons and potentially to the U.S. financial system.

Finally, in adopting these provisions we recognize that the CFTC Cross-Border Guidance appears to broadly opine that non-U.S. persons who receive any express guarantee from a U.S. affiliate should, as a general matter, count all of their dealing activity against the de minimis thresholds, regardless of whether a counterparty has recourse against the U.S. person in connection with the swap.[353] Our final rule is more targeted than the CFTC approach, in that our final rule requires a non-U.S. guaranteed affiliate to count only those dealing transactions for

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352 See note 335, supra, and accompanying text.

353 See CFTC Cross-Border Guidance, 78 FR at 45319. For those purposes, the CFTC Cross-Border Guidance interprets guarantees generally to include "not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, in view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations with respect to its swaps," and also refers to "keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements, and any other explicit financial support arrangements" as being types of guarantees notwithstanding that that they "may provide for different third-party rights and/or address different risks than traditional guarantees." See id. at 45319-20.

which the counterparty to the security-based swap has recourse against a U.S. person that is affiliated with the non-U.S. person. This reflects our decision to focus the application of the de minimis exception on recourse arrangements involving security-based swaps, while recognizing that some non-recourse arrangements could influence a U.S. person to provide financial support to non-U.S. persons and thereby present risk to the U.S. person and potential risk to the U.S. financial system.

2. Dealing Transactions of Non-U.S. Persons Involving U.S. and Other Counterparties

(a) Proposed Approach and Commenters' Views

Under the proposal, non-U.S. persons also would be required to count their dealing transactions entered into with a U.S. person, other than a foreign branch.[354] As discussed below, this proposed exclusion for transactions in which the counterparty is a foreign branch reflected concerns regarding U.S. banks being limited in their access to foreign counterparties when conducting dealing activity through their foreign branches.

The proposal solicited comment regarding whether non-U.S. persons should be required to count, towards their de minimis thresholds, transactions with U.S. persons or with foreign branches of U.S. banks. It also solicited comment regarding whether non-U.S. persons should be

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[354] See proposed Exchange Act rule 3a71-3(b)(1)(ii). For those purposes, "foreign branch" was defined to mean any branch of a U.S. bank if: the branch is located outside the United States; the branch operates for valid business reasons; and the branch is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where it is located. See proposed Exchange Act rule 3a71-3(a)(1). The proposal also included a definition of "transaction conducted through a foreign branch" that encompassed transactions solicited, negotiated, or executed through a foreign branch where the foreign branch is the counterparty to the transaction, and the transaction was not solicited, negotiated, or executed by a person within the United States. See proposed Exchange Act rule 3a71-3(a)(4).

Under the CFTC's cross-border guidance, as a general matter non-U.S. persons may exclude their dealing activities involving foreign branches of U.S. persons only if the U.S. person is registered with the CFTC as a swap dealer. See CFTC Cross-Border Guidance, 78 FR at 45319.

required to count the dealing transactions they enter into with registered security-based swap dealers, and regarding whether non-U.S. persons should be able to conduct dealing transactions within the United States without registering if their transactions are with a registered security-based swap dealer.[355]

Two commenters took the position that non-U.S. persons should have to count their transactions with foreign branches of U.S. banks against the de minimis thresholds, noting that those foreign branches themselves fall within the "U.S. person" definition,[356] and stating that excluding those transactions would serve as a loophole from regulation.[357] In contrast, one commenter stated that such transactions should be excluded from the de minimis analysis even if U.S. personnel are involved in soliciting, negotiating, executing or booking the transaction.[358]

Commenters also addressed the application of the exception to non-U.S. persons' dealing activities involving counterparties that are guaranteed affiliates of non-U.S. persons. The proposal did not require such transactions to be counted. One commenter expressed support for the fact that our proposal, unlike the CFTC's guidance, did not require non-U.S. persons to count

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355 See Cross-Border Proposing Release, 78 FR at 30995.

356 See AFR Letter I at 6 (supporting the premise that offices and branches of U.S. persons are "an integral part of the U.S. person" but arguing that it is inconsistent to treat such foreign branches different from their U.S. parent institutions); BM Letter at 18 (noting that the foreign branch of a U.S. person should be treated no differently than the U.S. person).

357 See AFR Letter I at 6-7 ("With these incentives [related to transactions with foreign branches, offices and guaranteed subsidiaries and affiliates of U.S. persons], it is unlikely that any foreign entities will choose to trade within the United States directly, and quite likely that U.S. financial institutions will simply advise their clients to trade with their foreign branches if they want to avoid Dodd-Frank"); BM Letter at 3, 18-19 ("This exception is no more than a loophole based upon a scare tactic, which will cause U.S. firms to operate their SBS business through offshore branches.").

358 See SIFMA/FIA/FSR Letter at A-15 to A-16 (supporting the proposed approach and urging the Commission to extend the exclusion to transactions between non-U.S. persons and foreign branches even if they are conducted within the United States).

certain transactions with non-U.S. counterparties that are guaranteed by U.S. persons.[359] On the other hand, one commenter stated that non-U.S. persons should count against the thresholds security-based swaps entered into with guaranteed affiliates and subsidiaries of U.S. persons if those affiliates and subsidiaries are not included within the "U.S. person" definition.[360] Also, as noted above, that commenter and one other commenter generally suggested that the presence of explicit or implicit guarantees of foreign affiliates should trigger application of the Exchange Act.[361]

(b) Final Rule

The final rule has been modified from the proposal to require non-U.S. persons (other than conduit affiliates[362]) to count, against the de minimis thresholds, their dealing transactions with U.S. persons other than certain transactions with the foreign branches of registered security-based swap dealers.[363] The proposal would have excluded all of the non-U.S. person's transactions with a foreign branch (other than "transactions conducted within the United States") regardless of the branch's registration status.

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359 See SIFMA/FIA/FSR Letter at A-17. Under the CFTC's guidance, non-U.S. persons would generally count certain dealing transactions involving counterparties that are guaranteed affiliates of U.S. persons, subject to exceptions. See CFTC Cross-Border Guidance, 78 FR at 45319.

360 See AFR Letter I at 7-8 and note 28 (stating that the proposal "incentivizes U.S. institutions to execute SBS indirectly by using foreign affiliates, subsidiaries, branches and offices," and thus lead U.S. institutions to incur risks "by trading with foreign entities without the full regulatory protections of Dodd-Frank"; also acknowledging that U.S. guarantors would count those trades for determining whether the guarantor is a major participant, but adding that major participants are subject to fewer requirements than dealers "so this is not a satisfactory method for addressing the risks presented by U.S. parent institutions guaranteeing the swaps of foreign subsidiaries and affiliates").

361 See note 333, supra.

362 The separate counting requirements applicable to conduit affiliates are addressed above. See section IV.D, supra.

363 See Exchange Act rule 3a71-3(b)(1)(iii)(A). "Foreign branch" is defined in Exchange Act rule 3a71-3(a)(2).

The requirement that such non-U.S. persons must count their dealing transactions with U.S. persons against the de minimis thresholds reflects the fact that dealing activity involving counterparties who are U.S. persons necessarily involves the performance, at least in part, of dealing activity within the United States. As discussed above, a non-U.S. person engaged in dealing activity with U.S. persons in an amount sufficient to implicate the de minimis thresholds reasonably can be concluded to constitute dealing activity within the United States by virtue of indicating that the non-U.S. person is commonly known in the trade as a security-based swap dealer within the United States, and that the non-U.S. person is regularly entering into security-based swaps as an ordinary course of business within the United States.[364] Similarly, that non-U.S. person seeks to profit by, among other things, providing liquidity within the United States and engaging in market making in security-based swaps within the United States, and its

[364] See section II.B.2(b)iii, supra. We also note that the Commission's traditional approach toward the registration of securities brokers and dealers under the Exchange Act generally requires registration of foreign brokers or dealers that, from outside the United States, induce or attempt to induce securities transactions by persons within the United States. See Cross-Border Proposing Release, 78 FR at 30990 n.213 and accompanying text.

In this regard we recognize that Exchange Act rule 15a-6, which provides an exemption for the activities of certain foreign broker-dealers, includes an exemption for transactions in securities with or for persons "that have not been solicited by the foreign broker or dealer." Exchange Act rule 15a-6(a)(1). In adopting this provision, the Commission stated that it "does not believe, as a policy matter, that registration is necessary if U.S. investors have sought out foreign broker-dealers outside the United States and initiated transactions in foreign securities markets entirely of their own accord." See 54 FR 30013, 30017 (Jul. 18, 1989). The Commission further stated that a narrow construction of "solicitation" would be inconsistent with the Exchange Act. See id. at 30018. We do not believe that a similar unsolicited exception – which reflects a policy decision rather than a matter of statutory scope – would be appropriate in this context, particularly given that situations in which non-U.S. persons engage in dealing activity with U.S. persons in an amount that is significant enough to implicate the de minimis thresholds would not appear consistent with a policy allowing non-U.S. persons to accommodate transactions which U.S. persons initiate "entirely of their own accord." Moreover, we note that the definition of "security-based swap dealer" includes persons that hold themselves out as security-based swap dealers or that are commonly known in the trade as security-based swap dealers. See Exchange Act section 3(a)(71)(A). Such persons may not actively solicit transactions from particular customers, and nothing in the statutory definition suggests that active solicitation on the part of such persons is required for them to fall within the definition of "security-based swap dealer."

decision to engage in dealing activity with U.S. persons affects the liquidity of the security-based swap market within the United States. U.S. persons incur risks arising from this dealing activity, which in turn potentially creates risk to the U.S. financial system more generally. Transactions with U.S. persons further raise market transparency and counterparty protection concerns that Title VII is intended to address. Accordingly, the dealing activity of such a non-U.S. person is best characterized as occurring, at least in part, within the United States to the extent that the dealing activity involves a U.S. person.[365] No commenters to the Cross-Border Proposing Release expressed opposition to generally requiring non-U.S. persons to count their dealing transactions with U.S. persons (other than comments regarding transactions with foreign branches, as discussed below).

The final rule permits such non-U.S. persons not to count certain dealing transactions conducted through a foreign branch of a counterparty that is a U.S. bank as part of the de minimis analysis. For this exclusion to be effective, persons located within the United States cannot be involved in arranging, negotiating, or executing the transaction. Moreover – and in contrast to the proposal – the counterparty bank must be registered as a security-based swap dealer,[366] unless the transaction occurs prior to 60 days following the effective date of final rules

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[365] For the above reasons, we conclude that this final rule is not being applied to persons who are "transact[ing] a business in security-based swaps without the jurisdiction of the United States," within the meaning of Exchange Act section 30(c). See section II.B.2(b)iii, supra. We also believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, market participants could engage in dealing activity with persons within the U.S. market, causing the U.S. person counterparties to incur associated risks simply by using non-U.S. persons to engage in those transactions with U.S. counterparties.

[366] See Exchange Act rule 3a71-3(b)(1)(iii)(A)(1).

As addressed in the Cross-Border Proposing Release, the ability of U.S. banks to conduct security-based swap activity potentially will be limited by section 716 of the Dodd-Frank Act, which in part prohibits certain federal assistance to security-based swap dealers, and by section

providing for the registration of security-based swap dealers.[367] Registration of the counterparty U.S. bank would not be required for the exclusion to be effective before then, given that the non-U.S. person would not be able to know with certainty whether the U.S. bank in the future would register with the Commission as a security-based swap dealer.[368]

As we noted in the proposal, although a foreign branch is part of a "U.S. person," and dealing transactions with foreign branches pose risk to the U.S. financial system, requiring non-U.S. persons to count transactions with foreign branches "could limit access of U.S. banks to non-U.S. counterparties when they conduct their foreign security-based swap dealing activity through foreign branches because non-U.S. persons may not be willing to enter into transactions with them in order to avoid being required to register as a security-based swap dealer."[369] We continue to believe that generally permitting a non-U.S. person not to count those types of transactions that do not involve U.S. personnel against the thresholds thus should help avoid the disparate treatment of foreign branches that engage in security-based swap dealing activity and that seek to access offshore dealing services, compared to other persons that engage in security-based swap dealing activities outside the U.S.

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619 of the Dodd-Frank Act, which in part prohibits banking entities from engaging in proprietary trading. See Cross-Border Proposing Release, 78 FR at 31002 n.326. The prohibitions of section 619 do not extend to certain market making activities. See Dodd-Frank Act section 619(d)(1)(B). In December of 2013, the Commission, together with the Office of the Comptroller of Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the CFTC, issued final rules implementing section 619 of the Dodd-Frank Act. See 79 FR 5536 (Jan. 31, 2014). In addition, based on our understanding of changes in the way major U.S. dealers engage with non-U.S. counterparties in the single-name CDS market following the issuance of the CFTC Cross-Border Guidance, we believe that few, if any, U.S. persons currently may participate in the single-name CDS market through their foreign branches.

367 See Exchange Act rule 3a71-3(b)(1)(iii)(A)(2).

368 In other words, this provision will help to avoid requiring non-U.S. persons to speculate whether their counterparties would register, and to face the consequences of their speculation being wrong.

369 Cross-Border Proposing Release, 78 FR at 31003.

The final rule differs from the proposal in that the final rule permits a non-U.S. person not to count its transactions with a foreign branch of a U.S. person against the de minimis thresholds only when the foreign branch is part of a registered security-based swap dealer (or for a temporary period of time prior to 60 days prior to the effectiveness of the dealer registration requirements), rather than transactions with any foreign branch. This tailoring of the proposal seeks to balance the above concerns that the proposed approach would result in disparate treatment of foreign branches and U.S. persons having inadequate access to liquidity located outside the United States, against the purposes of dealer regulation under Title VII. This consideration of competing interests results in an approach that will help to focus the application of the de minimis exception in such a way as to ensure that a registered security-based swap dealer is involved in the transaction, and thus that relevant Title VII provisions applicable to dealers (such as margin requirements) will apply to the transaction.[370] This manner of focusing the exclusion also is consistent with the approach taken by the CFTC in its cross-border guidance.[371]

In adopting an exclusion for certain transactions with foreign branches, we recognize that some commenters opposed having any such exclusion for a non-U.S. person's transactions with a foreign branch, stating that the breadth of the proposed exclusion would facilitate the avoidance of the Dodd-Frank Act even while U.S. entities incur the risks of transactions with

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370 We note that the mere involvement of a registered dealer in a transaction by itself would not implicate the above concerns regarding disparate treatment and liquidity that balance against the purposes of dealer regulation when it is not acting through a foreign branch, and thus by itself would not be sufficient to justify a more general exception to these counting principles (e.g., an exception for a non-U.S. person's dealing transactions involving any U.S. person that is registered as a security-based swap dealer).

371 See CFTC Cross-Border Guidance, 78 FR at 45319.

foreign entities, and that the exclusion would be based on a "scare tactic."[372] We nonetheless believe that this approach is justified by concerns about disparate treatment, along with associated liquidity concerns.[373] We also note that the modification of the proposal – such that transactions with foreign branches are excluded only if the foreign branch is part of a registered dealer – should help address concerns that the exclusion would promote evasion of the dealer requirements.[374] Also, as discussed below, a transaction would not constitute a "transaction conducted through a foreign branch" if personnel located in the United States were responsible for arranging, negotiating or executing the transaction.

We also recognize that commenters took the view that such an exclusion is inconsistent with the fact that foreign branches fall within the "U.S. person" definition.[375] In our view, the exclusion does not disregard the U.S.-person status of foreign branches. Instead, as discussed above, we believe that this exclusion is appropriate to address market concerns regarding disparate treatment of the dealing activity of foreign branches, notwithstanding that U.S.-person status.

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[372] See note 357, supra.

[373] In this regard we recognize that dealing activity involving foreign branches of U.S. banks does pose risks to the U.S. bank of which the foreign branch is a part and potentially to the U.S. financial system. Such risks are mitigated in part, however, in that foreign branches of banks that are registered security-based swap dealers will be subject to a number of Title VII regulatory requirements, including capital and margin requirements, that are designed to protect the system against those risks. Furthermore, this limitation is designed to help preserve liquidity throughout the system, given that absent the exclusion non-U.S. dealers may have reasons to favor non-U.S. counterparties to avoid the regulatory requirements of Title VII, which could threaten to fragment liquidity across geographical or jurisdictional lines.

[374] This modification – in conjunction with the fact that dealing transactions conducted through the foreign branch of a U.S. bank will have to be counted against the bank's de minimis thresholds regardless of counterparty (as was proposed) – will limit the possibility that U.S. banks could engage in a significant amount of security-based swap business through their foreign branches without either the banks or their non-U.S. counterparties being subject to dealer regulation.

[375] See note 356, supra.

We also have considered the view of one commenter that all of a non-U.S. person's transactions with foreign branches should be excluded from the analysis, even if U.S. personnel are involved in soliciting, negotiating, executing or booking the transaction.[376] As discussed elsewhere, we conclude that a non-U.S. person's dealing transactions within the United States should be counted against the thresholds.[377] More generally, for the reasons addressed above we conclude that the proposed exclusion related to a non-U.S. person's transactions with a foreign branch should be narrowed – not widened.

The final rule retains the proposed definition of "foreign branch," which encompasses any branch of a U.S. bank that is located outside the United States, operates for valid business reasons, and is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where it is located.[378] As discussed in the Cross-Border Proposing Release, we believe these factors appropriately focus on the location of the branch, the nature of its business and its regulation in a foreign jurisdiction.[379]

The final rule modifies the proposed definition of "transaction conducted through a foreign branch" to provide that the definition addresses transactions that are arranged, negotiated, and executed by a U.S. person through a foreign branch if both: (a) the foreign branch is the

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[376] See note 358, supra.

[377] See section II.B.2(b)iii, supra.

[378] See Exchange Act rule 3a71-3(a)(2).

[379] See Cross-Border Proposing Release, 78 FR at 31002. No commenters specifically addressed the proposed definition of "foreign branch."

We are adopting this definition as proposed while recognizing that it differs from the CFTC's interpretation of "foreign branch" in its cross-border guidance. See CFTC Cross-Border Guidance, 78 FR at 45329 (interpreting "foreign branch" in part by reference to designation by banking regulators, and by reference to the accounting of profits and losses). However, we believe that any foreign branch of a U.S. bank that would generally be considered a foreign branch under the CFTC Cross-Border Guidance also likely would be a foreign branch under our final rule.

counterparty to the transaction; and (b) the security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States.[380] We believe that this definition identifies the functions associated with foreign branch activity in a manner that appropriately focuses the exclusion for non-U.S. person's transactions toward situations in which the branch performs the core dealing functions outside the United States.[381]

Similar to the proposal, the final definition of "transaction conducted through a foreign branch" also states that a person need not consider its counterparty's activities in connection with the transaction – i.e., where its counterparty's personnel arranged, negotiated and executed the transaction – if the person received a representation from the counterparty that the transaction is arranged, negotiated, and executed on behalf of the branch solely by persons located outside the United States, unless the person knows or has reason to know that the representation is not accurate. For these purposes a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware,

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380 See Exchange Act rule 3a71-3(a)(3)(i). No commenters specifically addressed the proposed definition.

381 The proposed definition would have addressed transactions that are "solicited, negotiated, or executed" by persons outside the United States. The final rule refers to "arranged" in lieu of "solicited" to reflect the fact that a person may engage in dealing activity not only through transactions that the person actively solicits, but also through transactions that result from counterparties reaching out to the person. See generally Exchange Act section 3(a)(71)(A)(i) (defining "security-based swap dealer" in part to encompass any person who "holds themselves out as a dealer in security-based swaps").

Under the proposed rule, "transaction conducted through a foreign branch" was defined, in part, to exclude any transaction solicited, negotiated, or executed by a person within the United States on behalf of the foreign branch. See proposed Exchange Act rule 3a71-3(a)(4)(i)(B). Under the final rule, this element of the definition is set forth in the affirmative and provides that the transaction must be arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States. See Exchange Act Rule 3a71-3(a)(3)(i)(B). Consistent with the proposed rule, the final definition requires all relevant activity to be performed outside the United States for a transaction to fall within the definition of "transaction conducted through a foreign branch."

that it is not accurate.[382] This is intended to help address operational difficulties that a non-U.S. person otherwise could face in investigating the activities of its counterparty to ensure compliance with the rule.

Separately, the final rule, consistent with the proposal, does not require such non-U.S. persons to count, against the de minimis thresholds, their dealing transactions with non-U.S. persons whose security-based swap transactions are guaranteed by a U.S. person. We recognize the significance of commenter concerns regarding the risk posed to the United States by such security-based swaps, and regarding the potential use of such guaranteed affiliates to evade the Dodd-Frank Act.[383] We nonetheless believe that such concerns are adequately addressed by the requirement that guaranteed affiliates count their own dealing activity against the de minimis thresholds when the counterparty has recourse to a U.S. person. Although there can remain residual risk to U.S. markets associated with the security-based swaps involving such non-U.S. guaranteed affiliates, we do not believe that such risk is significant enough to warrant a requirement that non-U.S. persons count all of their dealing activity involving such non-U.S.

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382 See Exchange Act rule 3a71-3(a)(3)(ii). This representation provision within the final definition also contains certain clarifying changes from the proposal, in part to reflect the reference to "arranged" in lieu of "solicited." See note 364, supra. The final rule has been modified from the proposal to reflect the change in the definition of "transaction conducted through a foreign branch" described above. See note 382, supra. Also, consistent with the analogous representation provisions of the "U.S. person" definition, the final rule also changes the proposal to reflect that the non-U.S. person may not rely on the representation if it knows that the representation is not accurate, or has reason to know that the representation is not accurate; for these purposes a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate. This "know or have reason to know" standard should help ensure that potential security-based swap dealers and major security-based swap participants do not disregard facts that may call into question the validity of the representation. See note 302, supra, and accompanying text. In addition, applying a single standard of reliance to all representations regarding the status of a person or transaction for purposes of the final rule will reduce the potential complexity of establishing policies and procedures associated with reliance on such representations. See section IV.C.4, supra.

383 See note 360, supra.

guaranteed affiliates against their own de minimis thresholds. In this regard we note that such a requirement would necessitate certain non-U.S. persons to incur compliance costs associated with assessing whether their counterparties are guaranteed affiliates.[384] For similar reasons, the final rule does not require such non-U.S. persons to count, against the thresholds, their dealing transactions involving non-U.S. persons that are conduit affiliates.

F. Application of the Exception's Aggregation Principles to Cross-Border Dealing Activity

1. Proposed Approach and Commenters' Views

The Cross-Border Proposing Release also addressed the cross-border implementation of a previously adopted rule requiring a person to count dealing transactions by its affiliates against its own de minimis thresholds.[385] Under the proposal, a person engaged in dealing activity would have had to count: (i) dealing transactions by its U.S. affiliates, including transactions conducted through a foreign branch; and (ii) all dealing transactions of its non-U.S. affiliates where the counterparty is a U.S. person other than a foreign branch, or where the transaction is conducted within the United States.[386]

In the Cross-Border Proposing Release we took the view that the approach would be consistent with the Dodd-Frank Act's statutory focus on the U.S. security-based swap market, in

384 In taking this position we also recognize that the CFTC takes a different approach in its cross-border guidance, which generally considers it appropriate for such non-U.S. persons to count their dealing transactions with guaranteed affiliate counterparties, subject to certain exceptions. See CFTC Cross-Border Guidance, 78 FR at 45319, 45324 (stating there generally is no need for non-U.S. persons to count such dealing transactions with a counterparty that is a registered dealer, an affiliate of a registered dealer whose own dealing activities are below the relevant de minimis thresholds, or is guaranteed by a U.S. person that is not a financial entity).

385 See Exchange Act rule 3a71-2 (requiring that a person count against the thresholds its dealing activity plus that of "any other entity controlling, controlled by, or under common control with the person").

386 See proposed Exchange Act rule 3a71-3(b)(2).

that the dealing of a person's U.S. affiliates would impact the U.S. financial system regardless of the location of the affiliate's counterparty, but that the dealing of a person's non-U.S. affiliates with other non-U.S. persons outside the United States would not impact the U.S. financial system to the same extent. We also took the view that the aggregation approach would minimize the opportunity for a person to evasively engage in large amounts of dealing activity, and that the approach would be in accordance with other aspects of the proposal governing which transactions would be applied against the thresholds.[387]

The proposal separately would have permitted a person not to include, as part of the de minimis analysis, transactions by an affiliate that is registered as a security-based swap dealer, so long as the person's dealing activity is "operationally independent" of the dealer's activity.[388] For these purposes, the person and its registered dealer affiliate would be considered to be "operationally independent" if the two entities maintained separate sales and trading functions, operations (including separate back offices) and risk management.[389]

This aspect of the proposal recognized that any person affiliated with a registered dealer otherwise would have to count the registered affiliate's dealing activity against the person's own de minimis thresholds, which likely would require the person to register as a dealer if it engages in any dealing activity. We stated in the Cross-Border Proposing Release that, in our preliminary view, this outcome of preventing all affiliates of a dealer from taking advantage of the de minimis exception would not be consistent with the statutory purpose of the exception. We noted, moreover, that this scenario would not appear to raise the anti-evasion concerns at the

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387 See Cross-Border Proposing Release, 78 FR at 31004.

388 See proposed Exchange Act rule 3a71-4.

389 See Cross-Border Proposing Release, 78 FR at 31005.

core of the aggregation provisions, given that it would apply only where a corporate group already included a registered dealer subject to Commission oversight.[390]

A number of commenters opposed the operational independence condition to the proposed exclusion, arguing that it would hinder operational efficiency – including the use of group-wide risk management – without any countervailing benefit,[391] and that the requirement was vague and would impede the growth of different business models.[392] Commenters also pointed out that, in the parallel discussion in the CFTC's cross-border guidance, the CFTC did not interpret its cross-border statute as requiring operational independence.[393] One of these commenters further opposed the use of any aggregation requirement in connection with the de minimis exception.[394] One commenter expressed particular concerns regarding the application of aggregation principles in connection with joint venture arrangements involving dealer

[390] See id.

[391] See SIFMA/FIA/FSR Letter at A-13 to A-15 (stating that the operational independence condition is overbroad and unnecessary to achieve the statutory goals in that it "would have the effect of tying registration requirements to firms' internal risk management strategies or limited efficient leverage of back office functions" without any regulatory benefit and noting that the requirement would be burdensome for smaller market participants who would need to register solely due to their affiliation with larger entities); IIB Letter at 14-15 (stating that preventing the sharing of group-wide risk management and other resources would have the effect of nullifying the exclusion from the aggregation requirement for affiliates that are registered security-based swap dealers); JSDA Letter at 4-5 (stating that the "operationally independent" condition would discourage efficient global management of transactions).

[392] See JFMC Letter at 6-7.

[393] See SIFMA/FIA/FSR Letter at A-15; JFMC Letter at 6-7; IIB Letter at 14.

[394] See SIFMA/FIA/FSR Letter at A-12 to A-13 (stating that the aggregation requirement "effectively disregards the legal independence of entities" and that the Commission's existing anti-evasion capabilities are sufficient to guard against abuses; also stating that had the aggregation requirement been proposed as part of the underlying definitional rules SIFMA would have objected to the requirement).

shareholders.[395] One commenter supported the proposed approach as an anti-evasion safeguard.[396] One commenter suggested we eliminate the "operationally independent" requirement but, to prevent evasion of the dealer requirements, prohibit a registered dealer from using an unregistered affiliate as a booking vehicle.[397]

2. Final Rule

The final rule governing aggregation, like the proposal, generally applies the principles that govern the counting of a person's own dealing activity to also determine how the person must count its affiliates' dealing activities for purposes of the de minimis exception. Accordingly, the rule has been modified from the proposal to be consistent with changes to the proposed provisions regarding the counting of a person's dealing activity.

Moreover, the final rule modifies the exclusion from having to aggregate the dealing transactions of a person's registered dealer affiliate from the proposal, both to remove the operational independence condition and to address situations in which a person's affiliate has exceeded the de minimis thresholds but is in the process of registering as a dealer.

(a) General Provisions Regarding Aggregation of Cross-Border Transactions

The final rule, like the proposal, provides in part that if a person engages in dealing transactions counted against the de minimis thresholds, the person also must count all dealing transactions in which any U.S. person controlling, controlled by, or under common control with

395 See JSDA Letter at 5 (requesting that aggregation not be required of the minority shareholder of a joint venture); see also MUFJ Letter at 2-8 (generally opposing aggregation for such joint venture arrangements).

396 See BM Letter at 17 (stating that the condition is a safeguard that addresses evasion concerns while promoting the purpose of the de minimis exception).

397 IIB Letter at 14-15.

the person engages, including transactions conducted through a foreign branch.[398] The final rule has been revised from the proposal to further provide that the person should count all dealing transactions of its conduit affiliates.[399] Finally, the final rule has been modified from the proposal to provide that the person must count all dealing transactions of non-U.S. person affiliates that: (a) are entered into with U.S. persons other than the foreign branches of registered dealers; or (b) constitute dealing activity subject to a guarantee giving the non-U.S. person's counterparty rights of recourse against a U.S. person affiliated with the non-U.S. person.[400]

These modifications from the proposal are consistent with similar modifications made to the rules regarding the counting of a person's own transactions for purposes of the de minimis exception, and reflect the risk concerns and interests discussed above. The aggregation requirement serves to prevent evasion of the dealer registration requirements by persons that otherwise may seek to avoid dealer registration by simply dividing up dealing activity in excess of the de minimis thresholds among multiple affiliates.[401] In keeping with that purpose, in the cross-border context it is appropriate to require a person's affiliates to count the same dealing transactions that the person itself would be required to count for purposes of the de minimis

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398 See Exchange Act rule 3a71-3(b)(2)(i). Consistent with our position in the Intermediary Definitions Adopting Release (see 77 FR at 30631 n.437) and in the Cross-Border Proposing Release (see 78 FR at 31004), and with our position regarding the de minimis exception when there is a right of recourse against a U.S. person (see note 336, supra) for purposes of determining whether a person is controlling, controlled by, or under common control with another person (i.e., an affiliate), we interpret control to mean the direct or indirect power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.

399 See Exchange Act rule 3a71-3(b)(2)(ii).

400 See Exchange Act rule 3a71-3(b)(2)(iii) (cross-referencing the direct counting provisions of paragraph (b)(1)(iii), applicable to non-U.S. persons other than conduit affiliates); see also Sections IV.E, supra (addressing counting by non-U.S. persons engaged in dealing activity whose counterparties are U.S. persons); and IV.E.1 (addressing counting by non-U.S. persons engaged in dealing activity when their counterparties have recourse against a U.S. person).

401 See Intermediary Definitions Adopting Release, 77 FR at 30631.

exception – unless, as discussed below, the person is registered as a dealer.[402] Because this approach incorporates the direct counting standards discussed above, we believe that the approach implements the de minimis exception in a manner that is consistent with the Dodd-Frank Act's focus on the U.S. security-based swap market.[403]

(b) Application to Dealing Activities of Registered Affiliates

In addition, we are adopting an exception which provides that a person need not count against the de minimis thresholds the security-based swap transactions of an affiliate that either is: (1) registered with the Commission as a dealer; or (2) deemed not to be a dealer pursuant to

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[402] As noted above, one commenter questioned whether any aggregation principles should be applied in the de minimis context, arguing that the requirement disregards the legal independence of entities and disregards the possibility that two entities under common control may operate independently of each other. The comment further stated that the Commission's existing anti-evasion capacities are sufficient to guard against abuse without requiring aggregation. See note 391, supra. In our view, however, the aggregation provision is tailored appropriately to prevent evasion of the limits of the de minimis exception. See Intermediary Definitions Adopting Release, 77 FR at 30631 (discussing the use of the aggregation principles in light of the "increased notional thresholds of the final [definitional] rules, and the resulting opportunity for a person to evasively engage in large amounts of dealing activity if it can multiply those thresholds"; and addressing the use of the common control standard "as a means reasonably designed to prevent evasion of the limitations of that exception"). We further believe that this aggregation approach would be more effective at implementing the de minimis exception than a case-by-case approach, because the aggregation provision would provide upfront objective standards regarding which affiliate transactions must be counted against the thresholds, and thus help avoid uncertainty. Moreover, as discussed below, we are revising the aggregation provisions to allow the exclusion of the positions of affiliates that are registered as dealers (or that are in the process of registering), in response to comments.

[403] In short, we believe that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, corporate groups may engage in dealing activity above the de minimis thresholds within the United States while avoiding dealer regulation under Title VII by dividing up the dealing activity among multiple affiliated entities, none of which individually engages in dealing activity above the thresholds.

the provisions of Exchange Act rule 3a71-2(b), which addresses persons who have exceeded the de minimis thresholds but are in the process of registering.[404]

In part, this final rule has been modified from the proposal by removing the proposed operational independence condition. After considering the views of several commenters that the proposed operational independence condition would tend to inhibit operational efficiencies,[405] we are persuaded that excluding the condition from the final rule would help facilitate efficiency and avoid deterring beneficial group-wide risk management practices. In this regard we also note that even with the removal of the proposed operational independence condition, the aggregation provisions would prevent a corporate group from cumulatively engaging in aggregate relevant dealing activity – outside of its registered dealers – in excess of the de minimis thresholds.[406]

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404 See Exchange Act rule 3a71-4. This exception, when available, applies to all of the dealing of a person's registered dealing affiliate (or affiliate deemed not to be a dealer pursuant to the provisions of Exchange Act rule 3a71-2(b)), regardless of the counterparty or the location of the transaction, and regardless of whether the dealing transaction otherwise implicates cross-border issues.

405 See notes 391 and 392, supra.

406 We recognize that one commenter supported the proposed operational independence condition, stating that the condition would address evasion concerns while promoting the statutory purpose of the de minimis exception. See note 396, supra. After further consideration, however, we believe that the fact that the aggregation provision will still limit cumulative group-wide dealing activity by unregistered entities to no more than the de minimis thresholds should suffice as a safeguard against evasive activity. This is particularly true given that those thresholds are significantly below the amounts of dealing typically engaged in by persons above the thresholds. See Intermediary Definitions Adopting Release, 77 FR at 30636 (noting that, out of 28 potential dealers that had three or more counterparties that themselves were not recognized as dealers by ISDA, 15 of those exceeded a notional transaction threshold of $100 billion and accounted for over 98 percent of the total activity of all 28 entities).

We also note that certain commenters raised concerns about the application of the aggregation provisions generally in the context of joint ventures, particularly in the context of minority shareholders. See note 395, supra. Those issues regarding the scope of the aggregation provisions that the Commission previously adopted are not unique to the cross-border context, and in our view are outside the scope of this release. We note generally, however, that in the Intermediary Definitions Adopting Release we concluded that a common control standard is more

The final rule also has been modified from the proposal to permit a person to rely on this provision if its affiliate is in the process of registering as a dealer. The de minimis rule generally provides that a person that is not registered as a dealer but that no longer falls below the applicable de minimis thresholds nonetheless will be deemed not to be a dealer until the earlier of the date in which it submits a complete application for registration as a dealer, or two months after the end of the month that it becomes no longer able to take advantage of the exception.[407] That provision was intended to avoid market disruption in conjunction with the registration process.[408] Upon further consideration, we similarly believe that the provision at issue here should allow a person not to count the transactions of its affiliates that are in the process of registering as dealers, to avoid market disruption that may otherwise result due to the prospect of a person intermittently exceeding the de minimis thresholds when its affiliates are in the process of registering. Such situations, moreover, would not appear to provide practical opportunities for corporate groups to evade dealer registration by dividing dealing activities among multiple affiliates.

G. Exception for Cleared Anonymous Transactions

1. Proposed Approach and Commenters' Views

Three commenters expressed the view[409] that the Commission's final rules should include a provision similar to an aspect of the CFTC Cross-Border Guidance, which stated the CFTC's view that certain dealing transactions that are executed anonymously and cleared generally

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appropriate than a majority-ownership standard in the context of the anti-evasive purposes of the aggregation requirement. See Intermediary Definitions Adopting Release, 77 FR at 30631 n.437.

407 See Exchange Act rule 3a71-2(b).

408 See Intermediary Definitions Adopting Release, 77 FR at 30643.

409 See IIB Letter at 13-14; JSDA Letter at 4; JFMC Letter at 5.

would not be counted against the de minimis thresholds.[410] One commenter particularly emphasized that market participants would not have information available regarding a counterparty's identity in an anonymous transaction, and suggested that the prospect of becoming subject to dealer registration could deter non-U.S. liquidity providers from participating on security-based swap markets that provide access to U.S. persons.[411]

2. Final Rule

After considering commenter views we have concluded that this type of exception is appropriate, particularly given that the final de minimis rules turn in part on the domicile of the counterparty to the non-U.S. person, and this information would be unavailable to the non-U.S. person that is a counterparty to a cleared anonymous transaction. Absent such an exception, it is possible that execution facilities would exclude U.S. market participants to prevent their non-

[410] See CFTC Cross-Border Guidance, 78 FR at 45325 (stating that when a non-U.S. person that is not a guaranteed or conduit affiliate enters in to swaps anonymously on CFTC-registered platforms, and the swaps are cleared, the non-U.S. person would generally not have to count those swaps against the applicable thresholds, noting that, in such circumstances, the non-U.S. person would not have any prior information regarding its counterparty; also interpreting the CFTC's cross-border jurisdiction such that, with respect to such cleared and anonymously executed swaps, the non-U.S. person would generally satisfy certain transaction-level requirements).

The Cross-Border Proposing Release generally requested comment as to whether the proposed de minimis approach would place market participants at a competitive advantage or disadvantage, and as to whether there are other measures the Commission should consider to implement the de minimis exception. See Cross-Border Proposing Release, 78 FR at 30996. More generally, the Commission also requested comment regarding the proposals as whole, and regarding consistency with the CFTC's cross-border approach, including comments regarding the impact of differences between the two approaches, and comments regarding whether the Commission's proposed approach should be modified to conform with that taken by the CFTC. See id. at 31102.

[411] See IIB Letter at 13-14.

U.S. members from having to face the prospect of dealer regulation, which could impair market liquidity and increase costs and risks.[412]

For those reasons, the final rule has been revised from the proposal to except, from having to be counted against the de minimis thresholds, certain security-based swap transactions that a non-U.S. person enters into anonymously on an execution facility or national securities exchange and that are cleared through a clearing agency.[413]

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412 The exclusion for cleared anonymous transactions is intended to avoid placing market participants in a position where counterparty-related information needed for compliance would be unavailable, which may in turn lead execution facilities to exclude U.S. persons. We also note that the exclusion would strengthen incentives for shifting activity to transparent trading venues, which is a key goal of Title VII. While these transactions may pose risks to U.S. persons and to the U.S. financial system as a whole, those risks may be offset by the liquidity and transparency benefits that occur due to trading on transparent venues. Furthermore, the characteristics expected to be associated with central clearing (e.g., the daily exchange of mark-to-market margin) have parallels to the capital and margin requirements for registered dealers in terms of helping to protect the financial system against the risks introduced by particular transactions. On the other hand, such risk mitigation may be absent to the extent that the relevant clearing agency – which under the exception is not required to be registered with the Commission – does not follow standards consistent with the Title VII requirements applicable to registered clearing agencies.

413 See Exchange Act rule 3a71-5. This exception solely addresses the issue of whether a particular transaction needs to be counted against the de minimis thresholds. It does not address the issue of when a particular execution facility or clearing agency needs to register with the Commission. The Cross-Border Proposing Release separately addressed cross-border issues regarding when an execution facility or clearing agency would have to register with the Commission. See Cross-Border Proposing Release, 78 FR at 31054-58 (regarding security-based swap execution facility registration), 78 FR at 31038-40 (regarding clearing agency registration); see also Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011) (proposed rules regarding registration and other requirements applicable to security-based swap execution facilities).

This exception also does not address the application of section 5 of the Securities Act to such transactions. Rule 239 under the Securities Act (17 CFR 230.239) provides an exemption under the Securities Act for certain security-based swap transactions involving an eligible clearing agency. This exemption does not apply to security-based swap transactions not involving an eligible clearing agency, such as the anonymous transactions entered into on the execution facility or national securities exchange, regardless of whether the security-based swaps subsequently are cleared by an eligible clearing agency. See Exemptions for Security-Based Swaps Issued By Certain Clearing Agencies, Securities Act Release No. 9308 (Mar. 30, 2012), 77 FR 20536 (Apr. 5, 2012).

In particular, the final rule in part provides that a non-U.S. person need not count such cleared anonymous transactions against the threshold, unless the non-U.S. person is a conduit affiliate.[414] In addition, the final rule permits an affiliate (that itself may be a U.S. or non-U.S. person) of such a non-U.S. person not to count such transactions of the non-U.S. person against the affiliate's own thresholds for purposes of the aggregation provisions, unless the non-U.S. person is a conduit affiliate.[415]

The exception is not available when the non-U.S. person is a conduit affiliate because conduit affiliates are required to count all of their dealing transaction against the thresholds regardless of whether their counterparty is a U.S. or a non-U.S. person. As a result, the anonymous nature of the transaction would not cause implementation issues for conduit affiliates.

For purposes of the exception, a transaction would be "anonymous" only if the counterparty to the transaction in fact is unknown to the non-U.S. person prior to the transaction. The transaction would not be "anonymous" if, for example, a person submitted the transaction to an execution facility after accepting a request for quotation from a known counterparty or a known group of potential counterparties, even if the process of submitting the transaction itself did not involve a named counterparty.

H. Additional Issues

1. Particular Activities and Entities

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414 See Exchange Act rule 3a71-5(a). This exception applies regardless of whether the execution facility on which the transaction is entered into, or the clearing agency through which it is cleared, needs to be registered with the Commission. This is because the exclusion of U.S. market participants from an overseas execution or clearing facility – a result this exception is intended to guard against – could impair the markets regardless of whether the facility from which U.S. persons are excluded in fact are registered, and thus lead to increased costs and risks.

415 See Exchange Act rule 3a71-5(a)(2), (b).

Commenters to the Cross-Border Proposing Release raised issues regarding the application of the dealer registration requirement to limited security-based swap activities by certain "run-off" entities,[416] and in the context of portfolio compression.[417] Those issues are not unique to the cross-border context, and are outside of the scope of this release. We generally note, moreover, that in the Intermediary Definitions Adopting Release we considered and rejected certain requests for categorical exclusions from dealer definition. With regard to issues regarding the relevance of those or other activities to the de minimis analysis, we generally note that the dealer registration requirement necessarily distinguishes between a person's dealing and non-dealing activities.[418]

2. Foreign Public Sector Financial Institutions and Government-Related Entities

As discussed above, the final rule defining "U.S. person" (like the proposed definition of that term) specifically excludes several foreign public sector financial institutions and their agencies and pension plans, and more generally excludes any other similar international organization and its agencies and pension plans.[419] Certain commenters requested that we take further action to address the application of the dealer definition and its de minimis exception to security-based swap activities involving such foreign public sector financial institutions. Those

416 See SIFMA/FIA/FSR Letter at A-18 (addressing entities that are consolidating U.S.-facing dealing activities worldwide into one or a few registered dealers, but that may not be able to transfer or terminate their legacy security-based swap portfolios and thus may need to enter into new transactions in connection with those legacy portfolios); JSDA Letter at 4 (suggesting that including contract cancellations, alternations and transfers within the de minimis calculation "might invite a rush of cancellation before the enforcement of the proposed rules and make it difficult to cancel or transfer contracts for reducing risks").

417 See TriOptima Letter at 3-4 (explaining that portfolio compression services do not involve any of the enumerated factors that the Commission has identified as indicators of dealing activity).

418 See generally Intermediary Definitions Adopting Release, 77 FR at 30616-20 (discussing application of the dealer-trader distinction to security-based swap transactions).

419 See section IV.C.2(e), supra.

commenters in part stated that such organizations should not be required to register as security-based swap dealers, and that those organizations' affiliates should be considered immune from domestic regulation to the same extent as the organizations themselves.[420] In our view, however, such issues are outside the scope of this release, given that the source of any such privileges and immunities is found outside of the Dodd-Frank Act and the federal securities laws.

Separately, commenters stated that non-U.S. persons should not have to count their dealing transactions involving those organizations against the non-U.S. persons' dealer de minimis thresholds, on the grounds that counting such transactions would constitute the impermissible regulation of such organizations even if those were "transactions conducted within the United States."[421] As noted below, we have determined not to include the "transaction conducted within the United States" provisions in this final rule. With that said, we do not concur with the suggestion that counting a person's dealing transactions with such organizations against the de minimis thresholds – when otherwise provided for by the rules – involves the regulation of such organizations. Requiring a person to count, against the de minimis thresholds, the person's dealing transactions involving such an international organization as counterparty simply reflects the application of the federal securities laws to that person and its dealing

420 See, e.g., WB/IFC Letter at 2-4, 6-7 (also stating that such organizations should not be required to register as major participants or to clear security-based swaps, and that affiliates of such organizations should be excluded from the "U.S. person" definition); SC Letter at 16-24 (contending that the privileges and immunities afforded such organizations would be violated by their direct regulation as dealers or major participants, or by direct regulation equivalents, and that affiliates of such organizations also are immune from regulation); IDB Letter at 5. See also notes 225 and 229, supra.

421 See SC Letter at 18-19 (stating that the inclusion of such transactions against a counterparty's de minimis thresholds would be "tantamount to regulation of the operations of the World Bank and the IFC, in violation of their privileges and immunities"); WB/IFC Letter (incorporating SC Letter). These comments did not object to the inclusion of transactions between a U.S. person and an FPSFI, because the Commission would have jurisdiction to regulate that "U.S. person" for other reasons and it would not be regulated simply because it does business with the FPSFI. See SC Letter at note 21.

activities, and does not constitute the regulation of the international organization. A person's security-based swap dealing transaction with such an international organization accordingly are considered the same, for purposes of applying the de minimis thresholds and other Title VII requirements, as a dealing transaction with some other non-U.S. person counterparty.

Finally, two commenters stated that they should not be subject to the possibility of dealer regulation for comity reasons, on the grounds that they are arms of a foreign government.[422] We believe that such issues best are addressed on a case-by-case basis, but we generally note that the prospect of dealer regulation is relevant only to the extent that a person engages in dealing activity.

I. Economic Analysis of the Final Cross-Border Dealer De Minimis Rule

These final rules and guidance regarding the cross-border implementation of the de minimis exception to the "security-based swap dealer" definition will affect the costs and benefits of dealer regulation by determining which dealing transactions will be counted against the exception's thresholds.[423] The cross-border rules have the potential to be important in determining the extent to which the risk mitigation and other benefits of Title VII (such as market transparency and customer protection) are achieved, given the core role that dealers play within the security-based swap market and the market's cross-border nature.[424]

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422 See KfW Letter; FMS-WM Letter.

423 As we noted in the Intermediary Definitions Adopting Release, because the de minimis exception will determine which entities engaged in security-based swap dealing activity ultimately will be regulated as dealers under Title VII, the exception will have an effect on the burdens and benefits associated with dealer regulation. See Intermediary Definitions Adopting Release, 77 FR at 30628-30. The thresholds used in the de minimis exception accordingly were set at a level that sought to meet the goals of Title VII while appropriately minimizing the costs to market participants by providing for the regulation, as dealers, "of persons responsible for the vast majority of dealing activity within the market." See id. at 30638-40.

424 See section III.A, supra.

Commenters addressed the associated cost-benefit issues from a variety of perspectives. Some directly addressed the link between the cross-border scope of the dealer definition and the associated costs and benefits, by arguing that cost-benefit principles warranted greater harmonization with approaches taken by the CFTC or foreign regulators.[425] Commenters also addressed the need for cost-benefit analysis,[426] or questioned the adequacy of the Cross-Border Proposal's cost-benefit assessment.[427] Other comments that addressed the dealer definition

[425] See, e.g., IIB Letter (stating that cost-benefit considerations warrant harmonization to the CFTC and foreign regulatory authorities with regard to cross-border rules, and that divergence generally would be warranted only if the Commission's rules are more flexible, and thence would not preclude the voluntary adoption of consistent practices).

Although we have considered those comments that expressed complete or partial support in favor of consistency with the CFTC guidance, these final rules nonetheless follow approaches that differ from those taken by the CFTC in certain regards, generally by taking approaches that are narrower in scope than those adopted by the CFTC. See supra note 255 (Commission's definition of "U.S. person" differs from the CFTC approach in part by not including investment companies that beneficially are majority-owned by U.S. persons); note 353 and accompanying text (Commission's rules regarding the treatment of guaranteed affiliates of U.S. persons focuses on the presence of recourse against a U.S. guarantor, in contrast to the CFTC approach that more generally accounts for financial support commitments regardless of recourse rights), note 325(Commission's definition of "conduit affiliate" differs from the CFTC's approach in part by not considering financial statement treatment); note 379 (discussing expectation that any foreign branch of a U.S. bank that generally would be considered a foreign branch under the CFTC Cross-Border Guidance also likely would be a foreign branch under our final rule).

We also have considered initiatives by foreign regulators related to the regulation of OTC derivatives. In that regard, we note that the regulatory regimes in certain other jurisdictions do not provide for the registration of persons who function as dealers, in contrast to the approach Congress took in Title VII. Also, we expect to take into account the regulatory frameworks followed in other jurisdictions as we assess requests for substituted compliance in connection with the substantive requirements applicable to security-based swap dealers and other market participants. Those substituted compliance assessments are geared to promote Title VII in a way that fairly accounts for other regimes by assessing the requirements of those regimes on a function-by-function basis.

[426] See BM Letter, note 28, supra. As stated above, the Commission in fact is sensitive to the economic consequences of its rules, and has taken the costs and benefits into account in adopting these rules.

[427] See CDEU Letter, note 28, supra. This commenter particularly expressed the view that the Commission's proposal had failed to engage in an adequate consideration of cost-benefit principles, and instead stated that the Commission should "conduct a direct cost-benefit analysis of the conflicting rule regimes (e.g., with the European Market Infrastructure Regulation and the CFTC's cross-border guidance)." That commenter further expressed the view that, in requesting

implicate the tradeoff between the costs and benefits associated with the definition's scope, even when the commenters did not directly address the economic analysis in the Cross-Border Proposing Release or otherwise explicitly raise cost-benefit considerations.[428]

We have taken economic effects into account in adopting these final cross-border rules and providing guidance. In doing so, we believe that a narrow application of dealer regulation under Title VII – such as one that is limited to dealing activity that might be viewed as occurring solely within the United States – would not be sufficient to achieve the purposes of Title VII in light of the attributes of the security-based swap market, including the market's global nature, the concentration of dealing activity, the key role played by dealers and the risks posed by dealers via their legal and financial relationships. At the same time, we recognize that the cross-border application of Title VII has the potential to reduce liquidity within the U.S. market to the extent it increases the costs of entering into security-based swaps or provides incentives for particular market participants to avoid the U.S. market by operating wholly outside the Title VII framework.

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comment on the proposal's cost-benefit analysis, the Commission actually "asks the public to conduct such an analysis for the SEC" in lieu of the Commission having conducted its own analysis. See id.

In actuality, our request for comment simply gave the public the opportunity to address our economic analysis. The economic assessment in this release specifically addresses those economic impacts in a context where many entities may have taken steps to follow the CFTC's cross-border guidance, and also recognizes that market participants may seek to structure their activities to avoid Title VII given differences between Title VII regulation and the regulation present in foreign regimes.

428 For example, one comment in opposition to the proposed "operational independence" condition to the exception to the aggregation requirement for positions of affiliates that are registered as security-based swap dealers in part addressed the extra costs that would be associated with such a provision. See SIFMA/FIA/FSR Letter, note 391, supra. As discussed above, that proposed condition has been removed. See section IV.F, supra.

The cross-border rules applying the "security-based swap dealer" definition to cross-border dealing activity implicate two categories of costs and benefits. First, certain current and future participants in the security-based swap market will incur assessment costs in connection with determining whether they fall within the "security-based swap dealer" definition and thus would have to register with the Commission.

Second, the registration and regulation of some entities as security-based swap dealers will lead to programmatic costs and benefits arising as a consequence of the Title VII requirements that apply to registered security-based swap dealers, such as the capital, margin, and business conduct requirements.[429] These requirements may be expected to impose certain costs on participants acting as dealers, but also to produce benefits to the market and its participants, including counterparty protections and risk-mitigation benefits.

We discuss the programmatic and assessment costs and benefits associated with the final rules more fully below. We also discuss the economic impact of certain potential alternatives to the approach taken by the final rules.

1. Programmatic Costs and Benefits

(a) Cost-benefit Considerations of the Final Rules

Exchange Act rules 3a71-3, 3a71-4, and 3a71-5 will permit market participants to exclude certain dealing transactions from their de minimis calculations, and thus may cause particular entities that engage in certain dealing activities not to be regulated as security-based swap dealers. The rules accordingly may be expected to affect the programmatic costs and benefits associated with the regulation of security-based swap dealers under Title VII, given that

[429] See Cross-Border Proposing Release, 78 FR at 31135.

those costs and benefits are determined in part by which persons will be regulated as security-based swap dealers.[430]

This does not mean that there is a one-to-one relationship between a person not being a "security-based swap dealer" as a result of these cross-border rules, and the resulting change to programmatic benefits and costs. Indeed, although these rules may determine which particular entities will be regulated as dealers, it does not follow that total programmatic costs and benefits will vary by an amount proportional to the volume of those entities' dealing activity. As the Commission explained in the Intermediary Definitions Adopting Release, some of the costs and benefits of regulating dealers may be fixed, while others may be variable depending on a particular person's security-based swap dealing activity.[431] In practice, the programmatic benefits associated with the regulation of persons engaged in security-based swap dealing activity – in other words, the expected transparency, customer protection and market efficiency objectives associated with dealer regulation – likely will vary depending on the type and nature of those persons' dealing activity, including the degree to which those persons engage in security-based swap dealing activity within the United States or in a manner likely to give rise to Title VII concerns within the United States.

We believe that the cross-border rules we are adopting today will focus the regulation of security-based swap dealers under Title VII upon those entities that engage in security-based

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430 See Intermediary Definitions Adopting Release, 77 FR at 30724.

431 See id. ("Some of the costs of regulating a particular person as a dealer or major participants, such as costs of registration, may largely be fixed. At the same time, other costs associated with regulating that person as a dealer or major participant (e.g., costs associated with margin and capital requirements) may be variable, reflecting the level of the person's security-based swap activity. Similarly, the regulatory benefits that would arise from deeming that person to be a dealer or major participant (e.g., benefits associated with increased transparency and efficiency, and reduced risks faced by customers and counterparties), although not quantifiable, may be expected to be variable in a way that reflects the person's security-based swap activity.").

swap transactions that occur in the United States, or on the prevention of evasion. Our definition of "security-based swap dealer" seeks to capture those entities for which regulation of security-based swap activity is warranted due to the nature of their activities with other market participants.[432] Specifically, we have focused the rules on those market participants that are likely to have financial and legal relationships within the United States. This set of entities includes those that currently provide liquidity to U.S. persons as market makers in the OTC security-based swap market and those that trade with U.S. persons as market makers for security-based swaps on organized trading venues. Regulation of these entities will mitigate risk and promote stability for U.S. persons and potentially the U.S. financial markets by increasing the likelihood that they are able to meet their obligations under security-based swap contracts against counterparties with ties to the U.S. financial system once they are subject to the final adopted rules regarding the requirements applicable to dealers (rules establishing capital and margin requirements for registered security-based swap dealers). Furthermore, regulation of these entities as dealers may enable them to continue to provide liquidity to their counterparties, particularly in times when the markets are under financial stress and their counterparties may struggle to meet their financial obligations. We also believe that regulation of these entities will further other goals of Title VII, particularly as we consider future substantive regulation of the security-based swap market. In other words, these requirements will direct the application of the de minimis thresholds – which themselves are the product of cost-benefit considerations – toward those dealing activities in U.S. financial markets that most directly implicate the purposes of Title VII. As such, these rules reflect our assessment and evaluation of those programmatic costs and benefits:

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[432] See id. at 30617.

- Dealing by U.S. persons – The "U.S. person" definition captures entities whose security-based swap activities pose risks to the United States that may raise the concerns intended to be addressed by Title VII, regardless of the status of their counterparty.[433] The requirement that U.S. persons, including foreign branches, count all of their dealing transactions against the de minimis thresholds reflects the domestic nature of their dealing activity, particularly given that it is the financial resources of the entire person that enable it to engage in dealing activity.[434]
- Dealing by guaranteed affiliates of U.S. persons – The requirement that non-U.S. persons count all their dealing transactions that are subject to a recourse guarantee by a U.S. affiliate, even when the counterparty is another non-U.S. person, reflects the domestic nature of that activity and the risks that those recourse guarantees pose to U.S. persons and potentially to the U.S. financial system via the U.S. person guarantor.[435]
- Dealing by other non-U.S. persons with U.S.-person counterparties – The general requirement that non-U.S. persons count their dealing transactions with counterparties that are U.S. persons reflects the domestic nature of that activity and the concerns raised by the performance of dealing activity within the United States, impacts on U.S. market liquidity, risks that this dealing activity poses to U.S. persons and potentially toward the U.S. financial system as a whole, and counterparty and market transparency concerns.[436] This general requirement is limited, however, as it does not extend to transactions with

433 See section IV.C.3, supra.

434 See section IV.B.2, supra.

435 See section IV.E.1(b), supra. In the Cross-Border Proposing Release we preliminarily concluded that the risks associated with such guarantees could be adequately addressed through major participant regulation. We have reconsidered that view for the reasons discussed above.

436 See section IV.E.2(b), supra.

foreign branches of U.S. banks that are registered as dealers, or to certain cleared anonymous transactions. While those excluded transactions also involve the performance, at least in part, of relevant dealing activity within the United States, implicate Title VII concerns, and import risk into the United States – and their counting against the thresholds thus would be consistent with achieving the programmatic benefits of dealer regulation – their exclusion is nevertheless warranted by considerations regarding market access by U.S. persons (in the case of transactions with certain foreign branches of U.S. banks)[437] and by considerations regarding information availability and market liquidity (in the case of the exclusion for cleared anonymous transactions).[438]

- Anti-evasion provisions – The requirement that conduit affiliates count all of their dealing activities against the thresholds, and the cross-border application of the aggregation

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[437] See section IV.E.2(b), supra. Although dealing activity involving foreign branches of U.S. banks does pose risks to the U.S. bank of which the foreign branch is a part and potentially to the U.S. financial system, foreign branches of registered security-based swap dealers will be subject to a number of Title VII regulatory requirements, including capital and margin requirements, that are designed to protect the system against those risks. Furthermore, this limitation is guided in part by the desire to preserve liquidity throughout the system, given that absent the exclusion non-U.S. dealers may have reasons to favor non-U.S. counterparties to avoid the regulatory requirements of Title VII, which could threaten to fragment liquidity across geographical or jurisdictional lines.

[438] See section IV.G.2, supra. As noted above, see note 412, supra, the exclusion for cleared anonymous transactions is driven by concerns about counterparty-related information needed for compliance being unavailable, which in turn may lead U.S. persons to be excluded from certain execution facilities. The exclusion for such transactions also would be expected to have the effect of strengthening incentives for shifting activity to transparent trading venues, a key goal of Title VII. While these transactions of non-U.S. persons may pose risks to the U.S. bank of which the foreign branch is a part and potentially to the U.S. financial system as a whole, those risks may be offset by the liquidity and transparency benefits that occur due to trading on transparent venues. Furthermore, certain of the characteristics we expect to be associated with central clearing (e.g., the daily exchange of mark-to-market margin) serve similar functions as the capital and margin requirements for registered dealers in terms of helping to protect the financial system against the risks introduced by particular transactions. Of course, such risk mitigation may be absent to the extent that the relevant clearing agency – which under the exception is not required to be registered with the Commission – does not follow standards consistent with the Title VII requirements applicable to registered clearing agencies. As noted above, moreover, see note 413, supra, we are not addressing the registration requirements for such clearing agencies in this release.

requirements related to the de minimis exception, both reflect targeted efforts to prevent evasion of the security-based swap dealer requirements of Title VII.[439] We are adopting a definition of "conduit affiliate" that excludes affiliates of registered security-based swap dealers and major security-based swap participants to avoid imposing costs on registered persons in situations where the types of evasion concerns that the conduit affiliate definition is intended to address are minimal.

In short, these final rules apply the de minimis thresholds – which themselves reflect cost-benefit considerations[440] – to cross-border security-based swap activity in a way that directs the focus of dealer regulation toward those entities whose security-based swap dealing activities most fully implicate the purposes of Title VII, or that is reasonably designed to prevent evasion of dealer regulation under Title VII.

In the Cross-Border Proposing Release, we concluded that "[t]o the extent that an entity engaged in dealing activity wholly outside the United States poses risks to the U.S. financial system, we preliminarily believe that subjecting it to dealer registration and the related

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439 See sections IV.D.2 and IV.F.2, supra.

440 Based on an analysis of dealing activity within the security-based swap market, we concluded that a de minimis threshold of $3 billion for dealing activity involving security-based swaps would capture over 99 percent of dealing activity within the single-name CDS market under the ambit of dealer regulation. See Intermediary Definitions Adopting Release, 77 FR at 30639. We also concluded that this amount constituted a reasonable threshold, though not the only such threshold, for addressing the relevant competing factors – including the fact that the economic benefits provided by dealer requirements in large part will depend on the proportion of security-based swaps that are transacted subject to those requirements, while certain of the costs associated with dealer regulation would include costs that are independent of the amount of a person's dealing activity. See Intermediary Definitions Adopting Release, 77 FR at 30629, 30639.

As noted above, in application the general de minimis threshold currently is subject to an $8 billion phase-in level, and that phase-in level will remain in place until the Commission, following a study, either determines to terminate the phase-in level or adopts a different threshold. See part IV.A, supra.

requirements would not generate the types of programmatic benefits that Title VII dealer regulation is intended to produce, as the dealing activity of such entity poses risks to counterparties outside the United States."[441] These final rules and guidance regarding which transactions are to be counted against the de minimis thresholds are consistent with that principle, although in part they reflect a further assessment of the programmatic benefits resulting from the application of dealer regulation to non-U.S. persons when there is a recourse guarantee against a U.S. affiliate, including the benefits resulting from the application of financial responsibility requirements imposed upon registered security-based swap dealers. In this regard, the final rules and guidance reflect a reconsideration of our earlier conclusion that the risks to U.S. persons arising from such guarantees could adequately be addressed by the regulation of major security-based swap participants. In addition, these final rules and guidance more fully account for anti-evasion concerns associated with the potential for a U.S. person to engage in dealing activity using a guaranteed non-U.S. affiliate that is economically equivalent to the U.S. person itself entering into those dealing transactions.

(b) Evaluation of Programmatic Impacts

In setting the de minimis thresholds as part of the Intermediary Definitions Adopting Release, we attempted to identify a level of dealing activity that would identify and capture the entities for which the Title VII dealer requirements are most appropriate, without imposing the costs of Title VII on those entities for which regulation currently may not be justified in light of the purposes of the statute.[442] We particularly took into account data regarding the activities of participants in the security-based swap market, including data regarding activity suggestive of

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[441] See Cross-Border Proposing Release, 77 FR at 31137.

[442] See Intermediary Definitions Adopting Release, 77 FR at 30724-25.

dealing. Based on this analysis, we estimated that up to 50 entities in the security-based swap market might register as security-based swap dealers.[443] Those estimates – made outside of the context the cross-border application of the dealer definition – provide a baseline against which the Commission can analyze the programmatic costs and benefits and assessment costs of the final rules applying the de minimis exception to cross-border activities.

We believe the methodology used in the Intermediary Definitions Adopting Release also is appropriate for considering the potential programmatic costs and benefits associated with the final cross-border rules. This methodology particularly can help provide context as to how rules regarding the cross-border application of the de minimis exception may change the number of entities that must register as security-based swap dealers, and thus help provide perspective regarding the corresponding impact on the programmatic costs and benefits of Title VII. Applying that methodology to 2012 data regarding the single-name CDS market suggests that under these final rules approximately 50 entities may have to register as dealers – a number that is consistent with our estimates as part of the Intermediary Definitions Adopting Release.[444]

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[443] See section III.A.1, supra; see also Intermediary Definitions Adopting Release, 77 FR at 30635.

We stated that this was a "conservative" estimate. See Intermediary Definitions Adopting Release, 77 FR at 30725 and n.1457. In establishing the de minimis threshold, we analyzed the percentage of the market activity that would likely be attributable to registered security-based swap dealers under various thresholds and various screens designed to identify entities that are engaged in dealing activity. See id. at 30636. Our analysis placed particular weight on the screen that identified entities that engaged in security-based swap transactions with three or more counterparties that themselves were not identified as dealers by ISDA. See id. at 30636. Of the 28 firms and corporate groups that satisfied this criterion, 25 also engaged in activity over the $3 billion threshold. See id. Based on this analysis, together with our expectation that some of the included corporate groups would register more than a single security-based swap dealer and that new entrants may be likely to enter the market, we estimated that as many as 50 entities would ultimately be required to register as a security-based swap dealer. See id. at 30725 n.1457.

[444] While these revised figures are based on methodology similar to what Commission staff employed in the Intermediary Definitions Adopting Release, they make use of newer data and also account for the final rules' approach to counting dealing transactions against the de minimis thresholds.

We recognize that there are limitations to using this methodology to consider the potential programmatic impact of the cross-border rules. These include limitations associated with the fact that the available data does not extend to all types of security-based swaps,[445] and challenges in extrapolating transaction data into inferences of dealing activity.[446] Also, the

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Consistent with that methodology regarding the use of market data to identify entities that may be engaged in dealing activity pursuant to the dealer-trader distinction (see id. 30636 n.478), the data indicated that in 2012, 40 entities engaged in the single-name security-based swap market had three or more counterparties that were not identified by ISDA as dealers. Of those 40 entities, 27 had $3 billion or more in notional single-name CDS activity over a 12 month period. Applying the principles reflected in these final rules regarding the counting of transactions against the de minimis thresholds suggests that 25 of those entities would have $3 billion or more in notional transactions counted against the thresholds. Applying the aggregation rules (by aggregating the transactions, that are subject to counting, of other affiliates within a corporate group that individually do not have $3 billion in transactions subject to counting) increases that number to 26 entities. Based on this data, we believe that it is reasonable to conclude that up to 50 entities ultimately may register as security-based swap dealers, although fewer dealers also is possible.

To apply the counting tests of these final rules to the data, Commission staff identified DTCC-TIW accounts associated with foreign branches and foreign subsidiaries of U.S. entities and counted all transaction activity in these accounts against the firm's de minimis threshold. Commission staff further counted non-U.S. persons' activity against U.S. persons and foreign branches and subsidiaries of U.S. persons against the de minimis thresholds.

445 In these assessments, we have taken into account data obtained from DTCC-TIW regarding the activity of participants in the single-name CDS market. See Intermediary Definitions Adopting Release, 77 FR at 30635. The present assessments use data from 2012, rather than the 2011 period used in connection with the Intermediary Definitions Adopting Release.

As part of the Intermediary Definitions Adopting Release we also considered more limited publicly available data regarding equity swaps. See id. at 30636 n.476, and 30637 n.485. The lack of market data is significant in the context of total return swaps on equity and debt, in that we do not have the same amount of information regarding those products as we have in connection with the present market for single name CDS. See id. at 30724 n.1456. Although the definition of security-based swaps is not limited to single-name CDS, we believe that the single-name CDS data are sufficiently representative of the market to help inform the analysis. See id. at 30636.

446 As we noted in the Intermediary Definitions Adopting Release, the data incorporates transactions reflecting both dealing activity and non-dealing activity, including transactions by persons who may engage in no dealing activity whatsoever. See id. at 30635-36. For these purposes we have identified potential dealers based on whether an entity engaged in the single-name security-based swap market had three or more counterparties that were not identified by ISDA as dealers. We recognize that this may be imperfect as a tool for identifying dealing activity, given that the presence or absence of dealing activity ultimately turns upon the relevant facts and circumstances of an entity's security-based swap transactions, as informed by the dealer-trader distinction.

available single-name CDS data in certain regards potentially may lead the impact of these rules to be underestimated or overestimated:

- The Commission's access to data on CDS that are written on non-U.S. reference entities does not extend to data regarding transactions between two counterparties that are not domiciled in the United States, or guaranteed by a person domiciled in the United States.[447] More generally, the Commission's access to data also does not extend to transactions among affiliated entities. The available data thus does not extend to the activities of non-U.S. conduit affiliates, to the extent that they engage in transactions with non-U.S. persons (that themselves are not the subject of a guarantee), and potentially makes the assessment underinclusive to the extent that conduit affiliates engaged in dealing activity during the relevant period.
- The available data also does not specifically distinguish those transactions of non-U.S. persons that are subject to a guarantee by a U.S. person, and other (non-guaranteed) transactions by such non-U.S. persons. As a result, we have assumed that all foreign subsidiaries of U.S. persons rely on guarantees for all transactions, which potentially overestimates the level of transaction activity that would count toward de minimis thresholds for U.S. persons with foreign subsidiaries.

Separately, the programmatic costs and benefits associated with the implementation of these rules cannot be quantified with any degree of precision because the full range of the de minimis exception's effects on the programmatic costs and benefits also will reflect final rules –

[447] The Commission has more complete access to data regarding transactions involving single-name CDS on U.S. reference entities.

which have yet to be finalized – implementing the Title VII entity-level and transaction-level requirements applicable to security-based swap dealers.

In addition, the programmatic benefits and costs associated with the cross-border application of the de minimis exception may change as market participants modify their business structure or practices in response to these rules. To avoid the prospect of being regulated as a security-based swap dealer, some market participants may restructure their businesses or take other steps (such as avoiding engaging in security-based swap activities involving U.S. persons) to avoid having their dealing transactions counted against the de minimis thresholds. Other market participants may take similar steps in response to counterparty demands. We understand that some market participants already have taken these types of steps to restructure their derivatives operations in response to the implementation of Title VII requirements related to swaps. More fundamentally, there are inherent challenges associated with attempting to quantify the risk-mitigation and other benefits of financial regulation.[448] The programmatic impact of these rules may further reflect the fact that certain entities that are deemed to be security-based swap dealers, and hence are subject to the applicable Title VII dealer requirements, separately may be subject to other regulatory requirements that are analogous to the security-based swap dealer requirements. For example, we recognize that certain entities that are deemed to be

[448] In the Intermediary Definitions Adopting Release, we and the CFTC noted that we are "not of the general view that the costs of extending regulation to any particular entity must be outweighed by the quantifiable or other benefits to be achieved with respect to that particular entity." See Intermediary Definitions Adopting Release, 77 FR at 30630. We also noted that "it does not appear possible to demonstrate empirically – let alone quantify – the increase or decrease in the possibility that a financial crisis would occur at a particular future time and with a particular intensity in the absence of financial regulation or as a result of varying levels or types of financial regulation." See id. at 30630 n.421 (also noting the difficulty of demonstrating empirically "that the customer protections associated with dealer regulation would increase or decrease the likelihood that any particular market participant would suffer injury (or the degree to which the participant would suffer injury) associated with entering into an inappropriate swap or security-based swap").

security-based swap dealers pursuant to these rules also may be registered as swap dealers with the CFTC, pursuant to the CEA. Those entities' compliance with CFTC requirements applicable to swap dealers potentially may mitigate the programmatic effect of these rules – in terms of both costs and benefits – to the extent that those CFTC requirements are comparable with the SEC's yet-to-be-finalized substantive rules applicable to security-based swap dealers. The potential availability of substituted compliance, whereby a market participant may comply with a Title VII security-based swap dealer requirement by complying with a comparable requirement of a foreign financial regulator, also may affect the final programmatic impact of these rules.

In general, however, and consistent with our territorial approach, we believe that these rules are targeted appropriately, and do not apply dealer regulation to those entities that have a more limited involvement in the U.S. financial system and hence whose regulation as a security-based swap dealer under Title VII would be less linked to programmatic benefits (i.e., non-U.S. persons that engage in security-based swap dealing activity entirely, or almost entirely, outside the United States with non-U.S. persons or with certain foreign branches), while applying dealer regulation to those entities whose dealing activity would be more likely to produce programmatic benefits under Title VII. The nexus between specific aspects of these requirements and the programmatic costs and benefits also is addressed below in connection with our consideration of various alternatives to the approach taken in the final rules.

Finally, we recognize that the U.S. market participants and transactions regulated under Title VII are a subset of the overall global security-based swap market and that shocks to risk or liquidity arising from a foreign entity's dealing activity outside the United States may spill into the United States. Such spillover risks associated with dealing activity that falls outside the scope of Title VII have the potential to affect U.S. persons and the U.S. financial system either

through a foreign entity's transactions with foreign entities, which, in turn, transact with U.S. persons (and may, as a result, be registered security-based swap dealers or major security-based swap participants), or through membership in a clearing agency that may provide CCP services in the United States or have a U.S. person as a clearing member. We also have considered these spillovers in connection with our analysis of the effects of these final cross-border rules on efficiency, competition and capital formation.[449]

2. Assessment Costs

The analysis of how these cross-border rules will affect the assessment costs associated with the "security-based swap dealer" definition and its de minimis exception is related to the assessment cost analysis described in the Intermediary Definitions Adopting Release,[450] but must also account for certain issues specific to these cross-border rules. While in certain regards those assessment costs can more readily be estimated than the programmatic effects discussed above, the assessment costs associated with the cross-border application of the Title VII dealer requirements will be considerably smaller in significance than those programmatic effects.

The Intermediary Definitions Adopting Release addressed how certain market participants whose security-based swap activities exceed or are not materially below the de minimis threshold may be expected to incur assessment costs in connection with the dealer analysis.[451] In that release we estimated that 166 entities – out of over one thousand U.S. and non-U.S. entities that engaged in single-name CDS transactions in 2011 – had more than $2 billion in single-name CDS transactions over the previous 12 months, and as a result would

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449 See section VIII, supra.

450 See Intermediary Definitions Adopting Release, 77 FR at 30731-32.

451 See id. at 30731. These assessment costs include costs associated with analyzing a person's security-based swap activities to determine whether those activities constitute dealing activity and the costs of monitoring the volume of dealing activity against the de minimis threshold.

engage in the dealer analysis.[452] Based on those numbers, and assuming that that all of those entities retain outside counsel to analyze their status under the security-based swap dealer definition, including the de minimis exception, we estimated that the legal costs associated with assessing market participants' potential status as security-based swap dealers may approach $4.2 million.[453]

Application of these cross-border rules to the de minimis exception can be expected to affect the assessment costs that market participants will incur. In part, certain non-U.S. persons may be expected to incur personnel costs and legal costs – beyond the legal costs addressed as part of the Intermediary Definitions Adopting Release – associated with analyzing these cross-border rules and developing systems and procedures to assess which transactions would have to be counted against the de minimis thresholds (or with the purpose of avoiding activities within the United States that would be sufficient to meet the applicable thresholds). On the other hand, while certain market participants also would incur additional legal costs associated with the dealer determination (i.e., the assessment of whether particular activities constitute dealing activity for purposes of the analysis) addressed in the Intermediary Definitions Adopting Release, the application of the cross-border rules may reduce the number of entities that incur such legal costs.

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452 Id. at 30731-32. As discussed below, a comparable assessment using 2012 data indicates that there were approximately 210 entities in the single-name CDS market with more than $2 billion in transactions over 12 months. That analysis accounts for the aggregation of affiliate activity for purposes of the de minimis analysis, by first counting individual accounts with more than $2 billion in activity, and then aggregating any remaining accounts to the level of the ultimate parent and counting those also.

453 See id. We estimated that the per-entity cost of the dealer analysis would be approximately $25,000. Our estimate of aggregate industry-wide costs of $4.2 million reflected the costs that may be incurred by all 166 entities. See id.

In adopting these rules we estimate the assessment costs that market participants may incur as a result. As discussed below, however, these costs in practice may be mitigated in large part by steps that market participants already have taken in response to other regulatory initiatives, including the CFTC Cross-Border Guidance.

(a) Legal Costs

The implementation of these cross-border rules in some circumstances has the potential to change the legal costs identified in the Intermediary Definitions Adopting Release, including by adding new categories of legal costs that non-U.S. persons may incur in connection with applying the de minimis exception in the cross-border context.

Legal costs related to application of the dealer-trader distinction – As discussed in the Intermediary Definitions Adopting Release, certain market participants will incur assessment costs relating to performing the analysis as to whether their security-based swap activities constitute dealing. For purposes of that release we assumed that only entities with more than $2 billion in security-based swap transactions over the previous 12 months would be likely to engage in the full dealer analysis, and, based on analysis of single-name CDS data, we concluded that there were 166 market participants that would meet those criteria.[454]

In the cross-border context, we believe that some non-U.S. persons that have more than $2 billion in total security-based swap transactions over the previous 12 months nonetheless may be expected to forgo the costs of performing the dealing activity analysis, if only a comparatively low volume of their security-based swap activity involves U.S. counterparties or otherwise potentially needs to be counted against the de minimis thresholds. In particular, we believe that

[454] See id. at 30731-32. Using an estimate of $25,000 in legal costs per firm, this led to a total estimate of $4.2 million. See id. at 30732.

it is unlikely that non-U.S. persons would engage in the dealer analysis (and hence would not be likely to incur such legal costs described in the Intermediary Definitions Adopting Release) if over the previous 12 months they have less than $2 billion in security-based swap transactions that potentially would have to be counted against the thresholds.[455]

Available data from 2012 indicates that 218 entities worldwide (147 of which are domiciled in the United States and 71 domiciled elsewhere) had security-based swap activity, with all counterparties, of $2 billion or more. Of those 218 entities 202 had total activity of $2 billion or more that – to the extent it constituted dealing activity – would appear to have to be counted against the de minimis thresholds. Those 202 entities consisted of 147 entities domiciled in the United States (which would have to count all of their dealing transactions), and 55 entities domiciled elsewhere that have $2 billion in transactions with U.S. counterparties or that otherwise may have to be counted for purposes of the de minimis analysis.[456] To the extent that all 202 of those entities engage in the legal analysis related to which of their security-based swap activities constitutes dealing under the dealer-trader distinction (while recognizing that some such entities may conclude that, based on the nature of their business, they engage in dealing activities and that no such additional analysis is necessary), and assuming that such

455 See Cross-Border Proposing Release, 78 FR at 31141.

456 A total of 16 of those 71 entities that are not domiciled in the United States appear to have less than $2 billion in activity that involve U.S. counterparties or that otherwise would appear to potentially have to be counted against the de minimis thresholds.

analyses amount to $30,000 per entity,[457] those 202 entities would incur a total of approximately $6.1 million in such legal costs.[458]

Legal costs related to systems and analysis – As noted above, out of the 218 entities that had total security-based swap activity of $2 billion or more in 2012, 71 are domiciled outside of the United States. Upon further consideration (and in addition to the estimates in the Cross-Border Proposing Release), we also believe that it is reasonable to conclude that those 71 entities may have to incur one-time legal expenses related to the development of systems and analysis expenses – discussed below – to identify which of their total security-based swap transactions potentially must be counted for purposes of the de minimis analysis consistent with these cross-border rules. This additional cost estimate reflects the fact that the development of such systems and procedures must address cross-border rules that require accounting for factors such as whether an entity's security-based swaps are subject to guarantees from affiliated U.S. persons,

457 In the Intermediary Definitions Adopting Release, we estimated that such costs may range from $20,000 to $30,000. See Intermediary Definitions Adopting Release, 77 FR at 30732. For purposes of this analysis, we conservatively are using the upper end of that range.

458 This analysis of data related to potential assessment costs reflects both the activities of individual DTCC-TIW accounts as well as the activities of transacting agents. The analysis in particular first considers the number of accounts that have $2 billion or more in annual security-based swap activity, and then, after removing those particular accounts, considers activity aggregated at the level of individual transacting agents. This analysis is comparable to the analysis we use to estimate the potential number of dealers under the final rules. See note 444, supra. This analysis is distinct from the analogous analysis we used in the Intermediary Definitions Adopting Release to estimate the number of entities that may be expected to perform the dealer-trader analysis (see notes 149 through 151 and accompanying text, supra), which focuses on activity at the transacting agent level, because further experience with the associated data permits us to conduct a more granular analysis of that data. See generally Cross-Border Proposing Release, 78 FR at 31137 n.1407.

These estimates do not reflect a new category of costs arising from the cross-border rules. They instead are a revision of a category of previously identified costs that market participants may incur in engaging in the dealer-trader analysis, using newer data and reflecting only trades that are counted under the final cross-border rules.

and whether its counterparties are U.S. persons.[459] We estimate that such legal costs would amount to approximately $30,400 per entity, and that those 60 entities would incur total costs of approximately $2.2 million.[460]

(b) Costs related to Systems, Analysis, and Representations

Transaction-monitoring systems – The elements introduced by the final cross-border rules may cause certain non-U.S. persons to implement systems to identify whether their dealing transactions exceed the de minimis thresholds.[461] Such systems may reflect the need for non-U.S. persons to: (i) identify whether their dealing counterparties are "U.S. persons"; (ii) determine whether their dealing transactions with a U.S. person constitutes "transactions conducted through a foreign branch" (which itself requires consideration of whether their counterparty is a "foreign branch") and – of those – determine which transactions involve a foreign branch of a U.S. bank that itself is registered as a security-based swap dealer; (iii) determine whether particular transactions are subject to a recourse guarantee against a U.S.

459 We would not expect U.S. persons with more than $2 billion in activities to incur such costs, given that U.S. persons would need to count all of their dealing activities against the de minimis thresholds.

460 This estimate of $30,400 reflects an assumption that such efforts would require 80 hours of in-house legal or compliance staff's time. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the 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 staff estimates that the average national hourly rate for an in-house attorney is $380.

461 It is possible that a subset of non-U.S. dealers may reasonably conclude they are above the de minimis thresholds and should register with the Commission as security-based swap dealers, without establishing systems to analyze their status under the exception, in light of the nature of their operations and their activity within the United States.

Moreover, in considering the assessment costs associated with the final rules, we continue to hold the expectation, noted in the Intermediary Definitions Adopting Release, that market participants generally would be aware of the notional amount of their activity involving security-based swaps as a matter of good business practice. See Intermediary Definitions Adopting Release, 77 FR at 30732. These systems cost estimates for non-U.S. persons are provided in recognition of the fact that non-U.S. persons will likely need to distinguish those transactions that must be counted against their de minimis thresholds and those that do not need to be included.

affiliate; (iv) evaluate the applicability of the aggregation principles; and (v) evaluate the availability of the exception for cleared anonymous transactions.[462]

In general, we believe that the costs of such systems should be similar to the costs estimated in the Intermediary Definitions Adopting Release for a system to monitor positions for purposes of the major security-based swap participant thresholds. In both cases –the assessment of dealer status in the cross-border context and the assessment of major participant status – such systems would have to flag a person's security-based swaps against the specific criteria embedded in the final rules, and then compare the cumulative amount of security-based swaps that meet those criteria against regulatory thresholds.[463] Based on the methodology set forth in the Intermediary Definitions Adopting Release related to systems associated with the major participant analysis, we estimate that such systems would be associated with one-time programming costs of $14,904 and ongoing annual systems costs of $16,612 per entity.[464]

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462 In considering the assessment costs associated with the final rules, we believe that a potential dealer assessment of whether it is a "conduit affiliate" would not require the use of any systems. A conduit affiliate must count all of its dealing transactions, making transaction-specific tracking unnecessary. Moreover, the question of whether a person acts as a conduit affiliate would turn upon whether it engages in certain security-based transactions on behalf of a U.S. affiliate, accompanied by back-to-back transactions with that affiliate. That analysis fundamentally is different from the transaction-specific assessments that are more likely to require the development of new systems for monitoring the attributes of particular transactions.

463 As discussed in the Cross-Border Proposing Release, we would expect that market participants would be aware of the notional amount of their security-based swap activity as a matter of good business practice. See Cross-Border Proposing Release, 78 FR at 31140.

464 In the Intermediary Definitions Adopting Release, we estimated that the one-time programming costs of $13,692 per entity and annual ongoing assessment costs of $15,268. See Intermediary Definitions Adopting Release, 77 FR at 30734-35 and accompanying text (providing an explanation of the methodology used to estimate these costs). The hourly cost figures in the Intermediary Definitions Adopting Release for the positions of Compliance Attorney, Compliance Manager, Programmer Analyst, and Senior Internal Auditor were based on data from SIFMA's Management & Professional Earnings in the Securities Industry 2010.

For purposes of the cost estimates in this release, we have updated these figures with more recent data as follows: the figure for a Compliance Attorney is $334/hour, the figure for a Compliance Manager is $283/hour, the figure for a Programmer Analyst is $220/hour, and the figure for a

Analysis of counterparty status, including representations – Non-U.S. market participants also would be likely to incur costs arising from the need to assess the potential U.S.-person status of their counterparties, and in some cases to obtain and maintain records related to representations regarding their counterparties' U.S.-person status.[465] We anticipate that non-U.S. persons are likely to review existing information (e.g., information already available in connection with account opening materials and "know your customer" practices) to assess whether their counterparties are U.S. persons. Non-U.S. persons at times may also request and maintain representations from their counterparties to help determine or confirm their

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Senior Internal Auditor is $209/hour, each from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by SEC staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. We also have updated the Intermediary Definitions Adopting Release's $464/hour figure for a Chief Financial Officer, which was based on 2011 data, with a revised figure of $500/hour, for a Chief Financial Officer with five years of experience in New York, that is from http://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. See http://www.payscale.com (last visited Apr. 16, 2014). Incorporating these new cost figures, the updated one-time programming costs based upon our assumptions regarding the number of hours required in the Intermediary Definitions Adopting Release would be $15,287 per entity, i.e., (Compliance Attorney at $334 per hour for 2 hours) + (Compliance Manager at $283 per hour for 8 hours) + (Programmer Analyst at $220 per hour for 40 hours) + (Senior Internal Auditor at $209 per hour for 8 hours) + (Chief Financial Officer at $500 per hour for 3 hours) = $14,904, and the annual ongoing costs would be $16,612 per entity, i.e., ((Senior Internal Auditor at $209 per hour for 16 hours) + Compliance Attorney at $334 per hour for 4 hours) + (Compliance Manager at $283 per hour for 4 hours) + (Chief Financial Officer at $500 per hour for 4 hours) + (Programmer Analyst at $220 per hour for 40 hours) = $16,612).

465 Non-U.S. market participants potentially may also assess and seek representations related to whether their security-based swap activity with a particular counterparty constitutes transactions conducted through a foreign branch of a U.S. bank (including representations regarding the non-involvement of U.S. personnel) that is registered as a security-based swap dealer. Based on our understanding of changes in the way major U.S. dealers engage with non-U.S. counterparties in the single-name CDS market following the issuance of the CFTC Cross-Border Guidance, we believe that few, if any, U.S. persons currently may participate in this market through their foreign branches. Also, as noted above, other regulatory provisions may limit the ability of U.S. banks to conduct security-based swap activity. See note 366, supra. Accordingly, we do not believe that it is likely that non-U.S. market participants will independently assess, and seek representations related to, the foreign branch status of their counterparties. Instead, we believe that it is likely that such non-U.S. persons will focus on assessing the U.S.-person status of the bank for which the foreign branch is a part.

counterparties' status. Accordingly, in our view, such assessment costs primarily would encompass one-time costs to review and assess existing information regarding counterparty domicile, principal place of business, and other factors relevant to potential U.S.-person status, as well as one-time costs associated with requesting and collecting representations from counterparties.[466] The Commission believes that such one-time costs would be approximately $732 thousand per firm.[467]

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[466] We expect that an assessment of whether a particular counterparty is a U.S. person – once properly made – generally will not vary over time, given that the components of the "U.S. person" definition generally would not be expected to vary for a particular counterparty absent changes such as a corporate reorganization, restructuring or merger. With that said, we believe market participants will likely monitor for the presence of information that may indicate that the representations they have received in connection with a person's U.S.-person status are outdated or otherwise are no longer accurate (e.g., information regarding a counterparty's reorganization, restructuring, or merger).

We also believe that such non-U.S. persons will likely obtain the relevant information regarding the U.S.-person status of their new accounts as part of the account opening process, as a result of these and other regulatory requirements.

[467] In part, this estimate is based on each firm incurring an estimated one-half hour compliance staff time and one-half hour of legal staff time – per counterparty of the firm – to review and assess information regarding the counterparty, and potentially to request and obtain representations regarding the U.S.-person status of their counterparties. These are in addition to the assessment cost estimates we made in the Cross-Border Proposing Release, and reflect further consideration of the issue in light of industry experience in connection with the CFTC Cross-Border Guidance. For these purposes, we conservatively assume that each of those non U.S. firms will have 2400 single-name CDS counterparties (based on data indicating that the 60 non-U.S. persons with total single-name CDS transactions in 2012 of $2 billion or less all had fewer than 2400 counterparties in connection with single-name CDS), which produces an estimate of 1200 hours of compliance staff time and 1200 hours of legal staff time per firm. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2013 (modified by the 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 staff estimates that the average national hourly rate for a senior compliance examiner is $217 and that the average national hourly rate for an in-house attorney is $380; this leads to a cumulative estimate of approximately $716 thousand per firm for such costs.

Consistent with the Cross-Border Proposing Release, moreover, this estimate is further based on estimated 40 hours of in-house legal or compliance staff's time (based on the above rate of $380 per hour for an in-house attorney) to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be incorporated into standardized trading documentation used by market participants. This leads to an estimate of $15,200 per firm for such costs.

Monitoring of counterparty status – In addition, market participants may be expected to adapt the systems described above to monitor the status of their counterparties for purposes of their future security-based swap activities. Such refinements would permit these systems to maintain records of counterparty status for purposes of conducting the de minimis assessments (e.g., representations regarding a counterparty's U.S.-person status, or whether a counterparty's transaction through a foreign branch involve U.S. personnel), such as by monitoring for the presence of existing representations, to obviate the need to request representations on a transaction-by-transaction basis.[468] Market participants also may need to monitor for the presence of information that may indicate that the representation they have received are outdated or otherwise are not valid.[469] We estimate that this would require one-time costs of approximately $12,436 per firm.[470]

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468 The exclusion for a non-U.S. person's dealing transactions conducted through the foreign branch of a counterparty that is a registered security-based swap dealer is predicated on U.S.-based personnel of the counterparty not being involved in arranging, negotiating or executing the transaction at issue. Notwithstanding the potentially transaction-specific nature of that assessment, we believe that parties may structure their relationships in such a way that the non-U.S. person may rely on general representations by its counterparty, without the need for a separate representation in conjunction with each individual transaction.

469 It is possible that the need to monitor for information inconsistent with existing representations would be more significant in the context of representations regarding whether a transaction has been conducted through a foreign branch of a U.S. bank, than they would be in the context of representations regarding the U.S.-person status of a counterparty. This is because a counterparty's potential status as a U.S. person would not be expected to vary on a transaction-by-transaction basis. At the same time, we believe that few, if any, U.S. persons currently may participate in this market through their foreign branches. See note 465, supra.

470 In part, this is based on an estimate of the time required for a programmer analyst to modify the software to track whether the counterparty is a U.S. person (including whether it is a foreign branch of a U.S. bank that is not registered as a security-based swap dealer), and to record and classify whether a transaction constitutes dealing activity conducted through a foreign branch of a registered dealer This includes time associated with consultation with internal personnel, and an estimate of the time such personnel would require to ensure that these modifications conformed to those aspects of the final rule. Using the estimated hourly costs described above, we estimate the costs as follows: (Compliance Attorney at $334 per hour for 2 hours) + (Compliance Manager at $283 per hour for 4 hours) + (Programmer Analyst at $220 per hour for 40 hours) + (Senior

Summary of system, analysis and representation costs – In sum, we estimate that the costs that certain non-U.S. market participants would incur in connection with systems, analysis of counterparty status and representations in connection with these cross-border rules would be approximately $759 thousand in one-time costs,[471] and their estimated annual ongoing costs would be $16,612. The available data provided by the DTCC-TIW, subject to the limitations associated with the use of data analysis discussed above, suggests that such costs may be incurred by 71 non-U.S. domiciled entities with total annual activity of at least $2 billion. Assuming that each of these 71 entities concludes it has a need to monitor the above categories of information in connection with its security-based swap activities, we estimate that the total one-time industry-wide costs associated with establishing such systems would amount to approximately $54 million, and total annual ongoing costs would amount to approximately $1.2 million.

(c) Overall Considerations Related to Assessment Costs

In sum, we believe that the effect of these final cross-border rules would be an increase over the amounts that otherwise would be incurred by certain non-U.S. market participants, both in terms of additional categories of legal costs and in terms of the need to develop certain systems and procedures.

Internal Auditor at $209 per hour for 4 hours) + (Chief Financial Officer at $500 per hour for 2 hours) = $12,436. See note 464, supra (for source of the estimated per-hour costs).

As noted above, we generally would not expect a counterparty's U.S.-person status to vary over time absent changes such as reorganization, restructuring or merger. See note 466, supra.

471 Consistent with the above discussion, the estimated one-time costs of $759 thousand represent: the costs to establish a system to assess the status of their dealing activities under the definitions and other provisions specific to these cross-border rules ($14,904); the costs related to the assessment of counterparty status, including costs of assessing existing information and of requesting and obtaining representations, as well as costs of related procedures ($732 thousand), and the costs for monitoring the status of their counterparties for purposes of their future security-based swap activities ($12,436).

Requiring certain non-U.S. persons to incur such assessment costs is an unavoidable adjunct to the implementation of a set of rules that are appropriately tailored to apply the "security-based swap dealer" definition under Title VII to a global security-based swap market in a way that yields the important transparency, accountability, and counterparty protection benefits associated with dealer regulation under Title VII. The alternative – avoiding application of the Title VII dealer requirements to non-U.S. persons – would be inappropriate because, in our view, the dealing activity of non-U.S. persons required to count their dealing activity under these final rules constitutes part of the U.S. financial system. The benefits that arise from Title VII regulatory requirements, including risk management and transparency benefits associated with dealer regulation accordingly could be undermined if a significant portion of U.S. dealing activity by non-U.S. persons were excluded from the Title VII framework. In certain respects, however, decisions embedded in these final rules are designed to avoid imposing assessment costs upon market participants.[472]

It is important to recognize that our estimates of the assessment costs associated with these rules in practice may tend to overestimate that costs that market participants actually will incur as a result of these rules. This is because in practice, the assessment costs associated with the cross-border scope of the dealer definition (like the potential programmatic effects of that cross-border scope) may be tempered to the extent that the assessments that market participants conduct in connection with their security-based swap activities correspond to the assessments they otherwise would follow due to other regulatory requirements or business practices. Significantly, we understand that a substantial number of market participants already have

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[472] For example, the final rules incorporate an express representation provision in the "U.S. person" definition, to help the parties best positioned to make the U.S.-person determination and convey the results of that analysis to its counterparty. See section IV.C.4, supra.

engaged in assessment activities – including activities to determine whether their counterparties are U.S. persons – conforming to the requirements applicable to swaps. Given our expectation that persons that are not "U.S. persons" under the CFTC's policy (as set forth in its cross-border guidance) generally also would not be "U.S. persons" under our rules, certain market participants may reasonably determine that as part of the implementation of the rules we are adopting today they need not duplicate work already done in connection with implementing the CFTC's swaps regulations. In this regard we recognize the significance of commenter views emphasizing the importance of harmonization with the CFTC to control the costs associated with assessments under Title VII.[473] We acknowledge that, to the extent our final rules differ from the CFTC's approach – especially if they were to require counting of transactions that would not be captured by the requirements applicable to swaps in the cross-border context, or were to require the collection and/or consideration of information that is materially different from that collected under the CFTC's approach – market participants may face higher costs than if regulations were identical.[474] As discussed in connection with the specific aspects of these rules, however, we believe that such differences are justified, as are any associated assessment (or programmatic) costs.

Finally, we also anticipate that certain market participants that wish to limit the possibility of being regulated as a dealer under Title VII, including the programmatic and assessment costs associated with the dealer definition, may choose to structure their business to

[473] For example, one commenter urged the Commission to exempt from the definition of U.S. person collective investment vehicles that are publicly offered only to non-U.S. persons, consistent with the CFTC's interpretation, on account of the costs that would be required for collective investment vehicles that transact in both swaps and security-based swaps to develop separate compliance systems and operations for swaps and security-based swaps.

[474] In this regard we also note that in certain areas the Commission has taken an approach that is narrower than the CFTC analogue.

avoid engaging in dealing transactions with U.S. persons (other than foreign branches of banks registered with the Commission as dealers).

3. Alternative Approaches

As discussed above, the final rules incorporate a number of provisions designed to focus Title VII dealer regulation upon those persons that engage in the performance of security-based swap dealing activity within the United States in excess of the de minimis thresholds, taking into account the mitigation of risks to U.S. persons and potentially to the U.S. financial markets, as well as other purposes of Title VII.

In adopting these final rules we have considered alternative approaches suggested by commenters, including the economic effects of following such alternative approaches. In considering the economic impact of potential alternatives, we have sought to isolate the individual alternatives to the extent practicable, while recognizing that many of those alternatives are not mutually exclusive.

We further have considered such potential alternatives in light of the methodologies discussed above, by assessing the extent to which following particular alternatives would be expected to increase or decrease the number of entities that ultimately would be expected to be regulated as dealers under the final rules, as well as the corresponding economic impact. As discussed below, however, analysis of the available data standing alone would tend to suggest that various alternative approaches suggested by commenters would not produce large changes in the numbers of market participants that may have to be regulated as security-based swap dealers. These results are subject to the above limitations, however, including limitations regarding the ability to quantitatively assess how market participants may adjust their future activities in response to the rules we adopt or for independent reasons. Accordingly, while such analyses

provide some context regarding alternatives, their use as tools for illustrating the economic effects of such alternatives is limited.

(a) Dealing Activity by Foreign Branches of U.S. Banks

The final rules require U.S. banks to count all dealing transactions of their foreign branches against the de minimis thresholds, even when the counterparty is a non-U.S. person or another foreign branch of a U.S. person. Certain commenters to the rules addressed in the Intermediary Definitions Adopting Release had expressed the view that such transactions by foreign branches should not have to count their dealing transactions involving non-U.S. persons.[475] For the reasons discussed above, we believe that it is appropriate for the analysis to include dealing transactions conducted through foreign branches to the same extent as other dealing transactions by U.S. persons.[476]

Adopting such an alternative approach potentially could provide market participants that are U.S. persons with incentives to execute higher volumes through their foreign branches. Such an outcome may be expected in part to reduce the programmatic and assessment costs associated with dealer regulation under Title VII. Such an outcome also would be expected to reduce the programmatic benefits associated with dealer regulation, given that those U.S. banks (and potentially the U.S. financial system) would incur risks via their foreign branches equivalent to the risk that might arise from transactions of U.S. banks that are not conducted through foreign

475 See note 181, supra, and accompanying text. This issue – regarding whether a foreign branch of a U.S. bank should count all of its dealing activity against the de minimis thresholds – is distinct from the issue regarding the extent to which a non-U.S. person should count its dealing activity involving a foreign branch of a U.S. bank as a counterparty. That latter issue is addressed below. See section IV.I.3(d), supra.

476 See section IV.B, supra.

branches, but without the additional oversight (including risk mitigation requirements such as capital and margin requirements) that comes from regulation as a dealer.

Using the 2012 data to assess the impact associated with this alternative does not indicate a change to our conservative estimate that up to 50 entities potentially would register as security-based swap dealers.[477] This assessment, as well as the other assessments of alternatives discussed below, is subject to the limitations discussed above, including limitations regarding the ability to assess how market participants would change their activities in response to the final rules.

(b) Dealing Activity by Guaranteed Affiliates of U.S. Persons

The final rules require a non-U.S. person to count, against the de minimis thresholds, dealing transactions for which the non-U.S. person's performance in connection with the transaction is subject to a recourse guarantee against a U.S. affiliate of the non-U.S. person. Although the proposal instead would have treated such guaranteed affiliates like any other non-U.S. persons, we believe that this provision is appropriate for the reasons discussed above,

[477] The DTCC-TIW data permits us to separately consider dealing activity involving accounts of foreign branches of U.S. banks from other accounts of U.S.-domiciled persons. As a result, it is possible to consider the potential impact of a requirement under which – in contrast to the final rules – dealing activity conducted through a foreign branch only needs to be counted against the thresholds when the counterparty is a U.S.-domiciled person. Under such an alternative approach, the U.S. person would not have to count dealing transactions in which the counterparty is a non-U.S. person or another foreign branch of a U.S. bank.

As discussed above, current data indicates that there are 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period. Screening those entities against a cross-border test that is identical to the one we are adopting, except that it does not count foreign branches of U.S. banks as U.S. persons, leads to an estimate of 25 market entities that have $3 billion or more in activity that must be counted against the thresholds (rather than the 26 estimated in connection with the test we are adopting). That difference does not appear to warrant a change in the conservative estimate that up to 50 entities may register as security-based swap dealers.

including that such recourse guarantees pose risks to U.S. persons and potentially to the U.S. financial system via the U.S. guarantor.

This aspect of the final rules reflects a middle ground between commenter views, given that some commenters opposed any consideration of guarantees as part of the dealer analysis, while others expressed the view that all affiliates of a U.S. person should be assumed to be the beneficiary of a de facto guarantee from the U.S. person and, absent a showing otherwise, should have to count all of their dealing activity against the thresholds.[478] This diversity of commenter views suggests a range of potential alternatives to the final rules – including one alternative in which the final rules do not address guarantees at all, as well as alternatives in which (based on the concept of a de facto guarantee) all affiliates of a U.S. person, or at least all affiliates within a U.S.-based holding company structure, should have to count their dealing activity against the thresholds (with a potential exception if they demonstrate to the market that there will be no guarantee). For the reasons discussed above, we believe that the approach taken by the final rules is appropriate.[479]

Following such alternative approaches could be expected to lead to disparate economic effects depending on which approach is followed. On the one hand, an approach that does not require counting against the thresholds of a non-U.S. person's transactions with non-U.S. counterparties that are guaranteed by their U.S. affiliates would help provide incentives for greater use of guarantees by U.S. persons, with an increase of the associated risk flowing to the United States.[480] On the other hand, an approach that requires the conditional or unconditional

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478 See note 310, supra.

479 See section IV.E.1(b), supra.

480 In the Cross-Border Proposing Release, we expressed the preliminary view that dealer regulation of such persons would not materially increase the programmatic benefits of the dealer registration

counting of transactions by all affiliates of U.S. persons could provide incentives for certain non-U.S. holding companies to limit or eliminate relationships with U.S.-based affiliates, even if these affiliates perform functions unrelated to security-based swap activity. Additionally, a more limited approach that requires counting by non-U.S. subsidiaries of U.S. holding companies could reduce liquidity in the security-based swap market even if such a subsidiary's participation does not depend on the financial position or backing of its parent.

Data assessment of the first alternative does not indicate a change to our estimate that up to 50 entities may be expected to register with the Commission as security-based swap dealers.[481] The available data does not permit us to assess the other approaches, whereby all affiliates within a U.S.-based holding company, or all affiliates of any U.S. person generally, should have to count their dealing activity against the thresholds.[482]

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requirement, and that such an approach would impose programmatic costs without a corresponding increase in programmatic benefits to the U.S. security-based swap market. See Cross-Border Proposing Release, 78 FR at 31146-47. For the reasons discussed above, we have reached a different conclusion in conjunction with these final rules. See section IV.E.1(b), supra.

481 Although the data available to the Commission includes data regarding transactions of non-U.S. persons that are guaranteed by their U.S. affiliates, the data does not allow us to identify which individual transactions of those non-U.S. persons are subject to guarantees by their U.S. affiliates, or to distinguish the guaranteed and non-guaranteed transactions of such non-U.S. persons. As a result, the assessment of the final rule presumed that all transactions of foreign subsidiaries of U.S. persons for which we have data available constitute guaranteed transactions.

Screening the 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period, with a revised de minimis test that does not include any transactions with non-U.S. person counterparties entered into by a foreign subsidiary of a U.S. person produces 26 entities that would have more than $3 billion in notional transactions over 12 months counted against the threshold – a number that is identical to the number associated with the test we are adopting.

482 The available data does not include information about the single-name security-based swap transactions of non-U.S. domiciled persons (including non-U.S. affiliates of U.S.-domiciled persons) for single-name CDS involving a non-U.S. reference entity.

(c) Dealing by Conduit Affiliates

The final rules require that conduit affiliates of U.S. persons count all of their dealing transactions against the de minimis thresholds. The available data does not permit us to identify which market participants currently engage in security-based swap dealing activity on behalf of U.S. affiliates, and hence would be deemed to be conduit affiliates. Accordingly, we are limited in our ability to quantify the economic impact of this anti-evasion provision.

The economic effects of not including these provisions – and instead treating conduit affiliates the same as other non-U.S. persons – has the potential to be significant, as it would remove a tool that should help to deter market participants from seeking to evade dealer regulation through arrangements whereby U.S. persons effectively engage in dealing activity with non-U.S. persons via back-to-back transactions involving non-U.S. affiliates.[483] Following that alternative thus may partially impair the effective functioning of the Title VII dealer requirements, and lead risk and liquidity to concentrate outside of the U.S. market.

Another potential alternative approach to addressing such evasive activity could be to narrow the inter-affiliate exception to having to count dealing transactions against the de minimis thresholds, such as by making the exception unavailable when non-U.S. persons transact with their U.S. affiliates. Such an alternative approach may be expected to reduce the ability of corporate groups to use central market-facing entities to facilitate the group's security-based swap activities, and as such may increase the costs faced by such entities (e.g., by requiring additional entities to directly face the market and hence negotiate master agreements with dealers and other counterparties). We believe that the more targeted approach of incorporating the

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483 See note 314, supra, and accompanying text.

conduit affiliate concept would achieve comparable anti-evasion purposes with less cost and disruption.

(d) Dealing Activity by Non-U.S. Counterparties with Foreign Branches of U.S. Banks and Certain Other Counterparties

The final rules require non-U.S. persons to count, against the thresholds, their dealing transactions involving counterparties that are foreign branches of U.S. banks unless the U.S. bank is registered as a security-based swap dealer and unless no U.S.-based personnel of the counterparty are involved in arranging, negotiating and executing the transaction. This reflects a change from the proposal, which would have excluded all such transactions with a foreign branch regardless of whether the U.S. bank was registered as a dealer. The change appropriately takes into consideration the benefits of having relevant Title VII provisions applicable to dealers apply to the transaction against the liquidity and disparate treatment rationales underlying the exclusion.[484]

This aspect of the final rules reflects a middle ground between commenter views regarding transactions with foreign branches, given that some commenters expressed the view that all transactions with foreign branches should be counted against a non-U.S. person's de minimis threshold, while another commenter took the view that no such transaction should be counted.[485] This suggests at least two possible alternatives to the final rule – one in which all transactions with foreign branches are excluded from being counted against the thresholds, and one in which all transactions with foreign branches are counted against the thresholds (just like other transactions with U.S. person counterparties).

[484] See note 370, supra, and accompanying text.

[485] See notes 359 through 361, supra, and accompanying text.

The effect of adopting the first alternative – whereby all transactions with foreign branches are excluded from being counted – could provide U.S. market participants that are not registered as dealers with incentives to execute higher volumes of security-based swaps through their foreign branches, resulting in higher amounts of risk being transmitted to the United States without the risk-mitigating attributes of having a registered dealer involved in the transaction.[486] Adopting the second alternative – whereby all of a non-U.S. person's transactions with foreign branches are counted regardless of the registration status of the U.S. counterparty – would raise the potential for disparate impacts upon U.S. persons trading with foreign branches, along with associated concerns about liquidity impacts.

The available data allows for estimates related to both potential alternatives subject to the limitations discussed above, and neither alternative would be expected to indicate a change to our assessment that up to 50 entities may be expected to register with the Commission as security-based swap dealers.[487]

The final rules also incorporate definitions of "foreign branch" and "transaction conducted through a foreign branch" that potentially could be modified to reflect alternative approaches. While we do not believe that the economic impact of following such alternatives is readily quantifiable given the available data, we generally believe that any such effects would be

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486 In practice, based on our understanding of changes in the way major U.S. dealers engage with non-U.S. counterparties in the single-name CDS market following the issuance of the CFTC Cross-Border Guidance, we believe that few, if any, U.S. persons currently may participate in the single-name CDS market through their foreign branches. Also, as noted above, we recognize that other regulatory provisions may limit the ability of U.S. banks to conduct security-based swap activities. See note 366, supra.

487 Screening the 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period, with the two revised de minimis tests addressed above produces 26 entities that would have more than $3 billion in notional transactions over 12 months counted against the threshold – a number identical to the number associated with the test we are adopting.

limited, particularly in light of our understanding that few, if any, U.S. persons currently may participate in the single-name CDS market through their foreign branches.

Separately, the final rules do not require non-U.S. persons to count their dealing transactions with non-U.S. counterparties. Potential alternatives to that approach could be to require non-U.S. persons to count their dealing transactions with counterparties that are guaranteed affiliates of U.S. persons (at least with regard to transactions subject to the guarantees), or their dealing transactions with counterparties that are conduit affiliates.[488] The alternative approach of requiring non-U.S. persons to count dealing transactions with either or both of those types of non-U.S. counterparties potentially would increase the programmatic benefits associated with Title VII dealer regulation, by applying the risk mitigating aspects of dealer regulation (such as capital and margin requirements) to the dealer counterparties of persons whose security-based swap activities directly affect the United States, while recognizing that such risk mitigating benefits would be more attenuated than those that are associated with the final rules' approach of directly counting dealing transactions of such guaranteed and conduit affiliates. On the other hand, requiring non-U.S. persons to count such transactions would be expected to increase assessment costs by requiring such persons to evaluate and track whether their non-U.S. counterparties are guaranteed or conduit affiliates. Also, to the extent such an alternative approach causes non-U.S. dealers to avoid entering into transactions with affiliates of U.S. persons to avoid the need to conduct such assessments, the approach could reduce the

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488 For the reasons discussed above, we do not believe that it is necessary to require non-U.S. persons to count their dealing transactions with such non-U.S. counterparties. See section IV.E.2, supra.

Also, as discussed above, we anticipate soliciting additional public comment regarding counting of dealing transactions between two non-U.S. persons towards the de minimis exception when activities related to the transaction occur in the United States. See section I.A, supra.

liquidity available to corporate groups with U.S. affiliates, and further could provide an incentive for such corporate groups to move their security-based swap activity entirely outside the United States (which could impair the transparency goals of Title VII).

As we discussed in the Cross-Border Proposing Release, another potential approach related to the treatment of non-U.S. persons' dealing activities would be to not require the registration of non-U.S. persons that engage in dealing activity with U.S. person counterparties through an affiliated U.S. person intermediary.[489] In our view, such an approach would reduce the programmatic benefits associated with dealer regulation under Title VII, and would raise particular concerns related to financial responsibility and counterparty risk, as well as create risk to U.S. persons and potentially to the U.S. financial system.

(e) "U.S. Person" Definition

The "U.S. person" definition used by the final rules seeks to identify those persons for whom it is reasonable to infer that a significant portion of their financial and legal relationships are likely to exist within the United States and for whom it is therefore reasonable to conclude that risks arising from their security-based swap activities could manifest themselves within the United States, regardless of location of their counterparties. Because the definition incorporates decisions regarding a range of issues, the definition potentially is associated with a number of alternative approaches that could influence the final rules' economic impact.[490]

A particularly significant element of this definition addresses the treatment of investment vehicles. Under the final rule, a fund is a "U.S. person" if the vehicle is organized, incorporated

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489 See Cross-Border Proposing Release, 78 FR at 31146.

490 The issues regarding the treatment of foreign branches of U.S. banks – as potential dealers or as counterparties to non-U.S. persons that engage in dealing activity – that are addressed above also implicate the status of those foreign branches as "U.S. persons."

or established within the United States, or if its principal place of business is in the United States, which we are interpreting to mean that the primary locus of the investment vehicle's day-to-day operations is within the United States. One potential alternative approach to this element would be to make use of a narrower definition that does not use a principal place of business test for investment vehicles, and hence does not encompass vehicles that are not established, incorporated, or organized within the United States, even if the primary locus of their day-to-day operations is located here. Another potential approach would be to focus the meaning of "principal place of business" on the location where the operational management activities of the fund are carried out, without regard to the location of the fund's managers.

Similarly, another potential alternative approach to the "U.S. person" definition would be for the definition not to incorporate a principal place of business test for operating companies. Under such an alternative approach, an operating company would not fall within the "U.S. person" definition if it is not organized, incorporated or established within the United States, even if the officers or directors who direct, control and coordinate the operating company's overall business activities are located in the United States.

Following an alternative approach whereby the "U.S. person" definition did not encompass a "principal place of business" test, or whereby the definition followed a narrower such test with regard to particular types of market participants, may be expected to reduce the programmatic costs and benefits associated with dealer regulation, in that it may lead certain non-U.S. persons not to have to register as dealers notwithstanding dealing activities with such counterparties above the de minimis thresholds. Such an alternative approach also may promote market participants' use of such counterparties that are closely linked to the United States but that are not organized, incorporated or established within the United States, or that do not have

operational management activities within the United States, in lieu of entering into security-based swaps with U.S. persons. While such an approach may be expected to reduce programmatic costs, it also would reduce the programmatic risk mitigation and other benefits of dealer regulation under Title VII given that the "principal place of business" test helps to identify persons for which the risks associated with their security-based swap activities can manifest themselves within the United States.[491] Such an alternative approach may also be expected to reduce assessment costs incurred by non-U.S. persons, although such assessment costs in any event would be reduced by the ability of non-U.S. persons to rely on a counterparty's representation that the counterparty is not a U.S. person.

Aside from those issues related to the use of a "principal place of business" test, other aspects of the "U.S. person" definition also may affect the programmatic costs and benefits and assessment costs associated with dealer regulation. For example, the final rules do not encompass funds that are majority-owned by U.S. persons, although two commenters supported such an approach.[492] Also, the final "U.S. person" definition does not exclude investment vehicles that are offered publicly only to non-U.S. persons and are not offered to U.S. persons, although some commenters also supported this type of exclusion.[493]

For the reasons detailed above, we believe that including majority-owned funds within the definition of "U.S. person" would be likely to increase programmatic costs (by causing more investment funds to be subject to Title VII requirements) as well as assessment costs, while not significantly increasing programmatic benefits given our view that the composition of a fund's

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[491] See section IV.C.3(b)(ii), supra.

[492] See section IV.C.3(b)(iii), supra. The CFTC Cross-Border Guidance follows such an approach.

[493] See note 285 through 287, supra, and accompanying text. Here too, the CFTC Cross-Border Guidance follows such an approach.

beneficial owners is not likely to have significant bearing on the degree of risk that the fund's security-based swap activity poses to the U.S. financial system. Moreover, for the reasons discussed above, we also believe that an exclusion for publicly offered funds that are offered only to non-U.S. persons and not offered to U.S. persons, while likely to reduce programmatic costs, would also reduce programmatic benefits, by excluding certain funds from the definition of U.S. person based on factors that we do not believe are directly relevant to the degree of risk a fund's security-based swap activities are likely to pose to U.S. persons and potentially to the U.S. financial system.

Apart from those potential alternatives regarding the treatment of majority-owned funds and of investment vehicles offered only to non-U.S. persons, an additional alternative approach would be for the Commission simply to adopt the CFTC's interpretation of "U.S. person." We do not believe that following that alternative approach would be expected to have a significant effect on programmatic costs and benefits, given the substantive similarities between the CFTC's interpretation and our final rule. Adopting such an alternative approach, however, could have an impact on assessment costs. We particularly are mindful that some commenters requested that we adopt a consistent definition notwithstanding their views regarding specific features of the definition, in part because they believed that differences between our definition of "U.S. person" and the CFTC's interpretation of that term would significantly increase costs associated with determining whether they or their counterparties are U.S. persons for purposes of Title VII. We recognize that differences between the two definitions could lead certain market participants to incur additional costs that they would not incur in the presence of identical definitions. At the same time, we are adopting definitions of "U.S. person" and "principal place of business" that should be relatively simple and straightforward to implement, which should mitigate

commenters' concerns about the costs associated with different approaches to these terms. More generally, for the reasons discussed above we believe that the definitions we are adopting are the appropriate definitions for the cross-border implementation of Title VII in the security-based swap context.[494]

In addition, as discussed above, the final "U.S. person" definition does not follow an approach similar to the one used in Regulation S.[495] Because such an alternative approach would treat certain foreign branches of U.S. persons as non-U.S. persons, notwithstanding the entity-wide nature of the associated risks, following such an approach would be expected to reduce programmatic benefits by causing Title VII dealer regulation not to apply to certain dealing activities that occur in the United States and pose direct risks to U.S. persons. Although such an alternative approach potentially could impact assessment costs, given that certain market participants may already be familiar with the parameters of such a Regulation S approach, in our view the "U.S. person" definition we are adopting is more appropriate and simpler than an approach based on Regulation S.

Another potential alternative approach for addressing the "U.S. person" definition would be for the definition not to include the exclusion we are adopting with regard to specified international organizations. The alternative approach of not explicitly excluding such organizations from the definition could be expected to increase assessment costs – as counterparties to such organizations would have to consider those organizations' potential status

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494 See section IV.C, supra.

495 See section IV.C.3, supra.

as U.S. persons, which would implicate analysis of the privileges and immunities granted such persons under U.S. law – without likely countervailing programmatic benefits.[496]

The available data suggests that an alternative in which offshore funds managed by U.S. persons are excluded from de minimis calculations by non-U.S. persons would not be expected to indicate a change to our assessment that up to 50 entities may be expected to register with the Commission as security-based swap dealers.[497] We do not believe that other alternative approaches to the "U.S. person" definition are readily susceptible to quantitative analysis that would illustrate their potential programmatic and assessment effects.[498]

(f) Aggregation Requirement

The final rules apply the de minimis exception's aggregation requirement to cross-border activities in a way that reflects the same principles that govern when non-U.S. persons must directly count their dealing activity against the thresholds. The final rules thus have been revised from the proposal to incorporate other aspects of the way that the final rules require counting of

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496 Separately, as discussed above, we do not concur with the view of some commenters that a person's dealing activities involving such international organizations as counterparty should be excluded from having to be counted under the final rules. See section IV.3(e), supra. An alternative approach that followed those views would reduce the programmatic benefits of dealer regulation under Title VII, such as by permitting dealers that are U.S. persons to escape dealer regulation, notwithstanding the risk such U.S. dealers pose to the U.S. market, simply by focusing their dealing activities toward transactions with such international organizations.

497 Screening the 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period, with a revised de minimis test that does not count non-U.S. persons' dealing transactions involving offshore funds managed by U.S. persons produces 26 entities that would have more than $3 billion in notional transactions over 12 months counted against the threshold – a number identical to the number associated with the test we are adopting.

498 We note generally, however, that similarities between the definition of "U.S. person" in the final rules and the CFTC's interpretation of that term would help mitigate the assessment costs associated with the "U.S. person" determination. We do not believe that there are any significant differences, whereby a person that is a "U.S. person" for purposes of our final rules would generally not be a "U.S. person" for purposes of the CFTC Cross-Border Guidance, that may tend to increase assessment costs.

particular transactions against the thresholds. The final rules further have been modified from the proposal to remove the proposed "operational independence" condition to the exclusion that permits a person not to count transactions of its affiliates that are registered as security-based swap dealers.[499] These rules – like the incorporation of the aggregation requirement as part of the Intermediary Definitions Adopting Release – are intended to avoid evasion of the Title VII dealer requirements.

The final rules regarding the aggregation provision represent a middle ground between commenter views. One commenter specifically supported the proposal's "operational independence" condition that would limit when a person could exclude the dealing transactions of affiliates that are registered as dealers.[500] On the other hand, other commenters opposed any application of the aggregation provisions in the cross-border context (as well as more generally).[501] This suggests at least two alternatives – one in which the "operational independence" condition is retained, and one in which the aggregation requirement is further limited to only require U.S. persons to count dealing activities of affiliated U.S. persons.

The economic impact of retaining the proposed operational independence condition potentially would reduce efficiencies and deter beneficial group-wide risk management practices. Conversely, the impact of the alternative approach of further limiting the aggregation requirement, such that it addresses only affiliated U.S. persons, would facilitate market

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[499] By removing the proposed "operational independence" condition, the final rule provides that a person need not count the transactions of its registered dealer affiliate regardless of whether the person and the registered dealer affiliate are operationally independent.

The final rule also has been revised from the proposal to make the exclusion for registered dealer affiliates also available when an affiliate is in the process of registering as a dealer.

[500] See note 396, supra.

[501] See note 391 through 395, supra.

participants' evasion of the dealer regulation requirement by dividing their dealing activity among multiple non-U.S. entities.

The economic impact of the alternative approach of retaining the "operational independence" condition is not readily susceptible to quantification, given the lack of data regarding the extent to which affiliates that engage in security-based swap activities jointly make use of back office, risk management, sales or trades, or other functions. Analysis of data related to the alternate approach under which the requirement would be further limited to aggregating transactions of affiliated U.S. persons would not be expected to indicate a change to our assessment that up to 50 entities may be expected to register with the Commission as security-based swap dealers, subject to the limitations discussed above.[502]

(g) Exception for Cleared Anonymous Transactions

The final rules include an exception whereby non-U.S. persons need not count, against the thresholds, transactions that are entered into anonymously and are cleared. This exception reflects limits on the potential availability of relevant information to non-U.S. persons, as well as potential impacts on liquidity that may result absent such an exception.

The likely impact of the alternative approach of not including such an exception could be to deter the development of anonymous trading platforms, or to reduce U.S. persons' ability to participate in such platforms. In this regard the alternative can be expected to help reduce the

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[502] Screening the 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period, with a revised de minimis test that limits aggregation to U.S. affiliates within a corporate group produces 26 entities that would have more than $3 billion in notional transactions over 12 months counted against the threshold – a number identical to the number associated with the test we are adopting.

programmatic benefits of Title VII. The impact of the alternative approach of not including this type of exception is not readily susceptible to quantification.[503]

V. Cross-Border Application of Major Security-Based Swap Participant Thresholds

A. Overview

The statutory definition of "major security-based swap participant" encompasses persons that are not dealers but that nonetheless could pose a high degree of risk to the U.S. financial system.[504] The statutory focus of the "major security-based swap participant" definition differs from that of the "security-based swap dealer" definition, in that the latter focuses on activity that may raise the concerns that dealer regulation is intended to address, while the former focuses on positions that may raise systemic risk concerns within the United States.[505] The definition focuses on systemic risk issues by targeting persons that maintain "substantial positions" that are "systemically important," or whose positions create "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets."[506] The statute further directed us to define the term "substantial position"

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[503] Based on our understanding of the market, transactions in security-based swaps in general currently would not be eligible for the exception because transactions currently are not anonymous.

[504] As discussed in the Intermediary Definitions Adopting Release, the major security-based swap participant definition employs tests incorporating terms – particularly "systemically important," "significantly impact the financial system" or "create substantial counterparty exposure" – that denote a focus on entities that pose a high degree of risk through their security-based swap activities. See Intermediary Definitions Adopting Release, 77 FR at 30661 n.761. That discussion also noted that the link between the major participant definitions and risk was highlighted during the congressional debate on the statute. See id. (citing 156 Cong. Rec. S5907 (daily ed. July 15, 2010) (citing colloquy between Senators Hagen and Lincoln, discussing how the goal of the major participant definitions was to "focus on risk factors that contributed to the recent financial crisis, such as excessive leverage, under-collateralization of swap positions, and a lack of information about the aggregate size of positions.")).

[505] See section II.B.2(c), supra.

[506] See section 3(a)(67) of the Exchange Act. The statute defines a "major security-based swap participant" as a person that satisfies any one of three alternative statutory tests: a person that

at the "threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States."[507]

In the Intermediary Definitions Adopting Release, we, together with the CFTC, adopted rules defining what constitutes a "substantial position" and "substantial counterparty exposure."[508] In doing so, we concentrated on identifying persons whose large security-based swap positions pose market risks that are significant enough that it is prudent to regulate and monitor those persons.[509] The definition incorporates a current exposure test and a potential future exposure test designed to identify such persons.[510]

We addressed the application of the major participant definition to cross-border security-based swaps in the Cross-Border Proposing Release, proposing that a U.S. person consider all

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maintains a "substantial position" in swaps or security-based swaps for any of the major swap categories as determined by the Commission; a person whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or a person that is a "financial entity" that is "highly leveraged" relative to the amount of capital it holds (and that is not subject to capital requirements established by an appropriate Federal banking agency) and maintains a "substantial position" in outstanding security-based swaps in any major category as determined by the Commission.

507 See Exchange Act section 3(a)(67)(B).

508 See Intermediary Definitions Adopting Release, 77 FR at 30663-84.

509 See id. at 30661, 30666.

510 See id. at 30666 (noting the use of such tests in context of "substantial position" definition); id. at 30682 (noting use of such tests in context of "substantial counterparty exposure" definition). We also noted that our definition of "substantial position" was intended to address default-related credit risks, the risk that would be posed by the default of multiple entities close in time, and the aggregate risks presented by a person's security-based swap activity, as these considerations reflect the market risk concerns expressly identified in the statute. We interpreted "substantial counterparty exposure" in a similar manner, noting the focus of the statutory test on "serious adverse effects on financial stability or financial markets." Id. at 30683. Cf. section 3(a)(67)(A)(ii)(II) of the Exchange Act (encompassing as major security-based swap participants persons "whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets").

security-based swap positions entered into by it, and also proposing that a non-U.S. person consider only its positions with U.S. persons but not its positions with other non-U.S. counterparties, even if the positions are entered into within the United States or the non-U.S. counterparties are guaranteed by a U.S. person.[511]

In the proposal, we also explained our preliminary view on the application in the cross-border context of the general principles regarding attribution, which were set forth in guidance in the Intermediary Definitions Adopting Release. Specifically, we stated that a person's security-based swap positions must be attributed to a parent, affiliate, or guarantor for purposes of the major security-based swap participant analysis to the extent that the counterparties to those positions have recourse to that parent, affiliate, or guarantor in connection with the position.[512] This treatment was intended to reflect the risk focus of the major security-based swap participant definition by providing that entities will be regulated as major security-based swap participants when the guarantees they provide pose a sufficiently high level of risk to the U.S. financial system.[513]

Commenters raised several issues related to the proposed approach for applying the major security-based swap participant definition to cross-border security-based swaps. As discussed below, these include issues regarding: the treatment of a non-U.S. person's positions with foreign branches of U.S. banks, the treatment of guarantees, and the treatment of entities with legacy positions. Commenters also requested that the Commission generally harmonize its rules and guidance with the CFTC's Cross-Border Guidance.

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511 See proposed Exchange Act rule 3a67-10(c); Cross-Border Proposing Release, 78 FR at 31030.

512 See Cross-Border Proposing Release, 78 FR at 31031 and n.625. Cf. Intermediary Definitions Adopting Release, 77 FR at 30689 (describing same attribution treatment in context of domestic security-based swap activities).

513 See Cross-Border Proposing Release, 78 FR at 31032.

After considering commenters' views, we are adopting final rules that have been modified from the proposal in certain important respects. As addressed in further detail below, key changes to the proposal include:

- A requirement that a conduit affiliate, as defined above, must include in its major security-based swap participant threshold calculations all of its security-based swap positions;
- A requirement that a non-U.S. person other than a conduit affiliate must include in its major security-based swap participant threshold calculations all of its security-based swap positions for which its counterparty has rights of recourse against a U.S. person; and
- A modification to the proposed requirement that a non-U.S. person must include in its major security-based swap participant threshold calculations security-based swap positions with foreign branches of U.S. banks.[514]

Our approach to the application of the major security-based swap participant definition in the cross-border context incorporates certain principles that also apply in the context of the

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[514] In addition to the changes listed above, the final rules do not include certain provisions that were included in proposed Exchange Act rule 3a67-10 because those provisions, which defined "foreign major security-based swap participant," and addressed the application of business conduct requirements to registered foreign major security-based swap participants, were relevant to proposed rules regarding substantive requirements that were included in the Cross-Border Proposing Release. As this release only addresses various definitional rules and not those substantive requirements that were proposed, those provisions are not relevant to this release and are not addressed. Those provisions may, however, be relevant to matters addressed in subsequent rulemakings.

The final rules applying the major security-based swap participant definition also incorporate a conforming change by referring to such person's "positions" rather than "transactions." This is consistent with the use of the term "positions" in the statutory definition of major security-based swap participant and the rules further defining that term.

dealer definition and that are set forth in the Intermediary Definitions Adopting Release.[515] First, as in the Intermediary Definitions Adopting Release, we interpret the term "person" to refer to a particular legal person, meaning that we view a trading desk, department, office, branch, or other discrete business unit that is not a separately organized legal person as a part of the legal person that enters into security-based swap positions.[516] Thus, a legal person with a branch, agency, or office that exceeds the major security-based swap participant thresholds is required to register as a major security-based swap participant as a legal person, even if the legal person's positions are limited to such branch, agency, or office.[517] In addition, consistent with rules adopted in the Intermediary Definitions Adopting Release, cross-border security-based swap positions between majority-owned affiliates will not be considered for purposes of determining whether the person as a whole is a major security-based swap participant.[518]

B. Application of the Major Security-Based Swap Participant Definition to U.S. Persons

1. Proposed Approach and Commenters' Views

Under the proposal, a U.S. person would have considered all of its security-based swap positions for purposes of the major participant analysis.[519] Commenters did not comment on this aspect of the proposed approach, although, as discussed above, several commenters addressed the proposed scope of the "U.S. person" definition.[520]

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515 See Intermediary Definitions Adopting Release, 77 FR at 30624 (discussing our guidance regarding the meaning of the term "person" as used in security-based swap dealer definition). Cf. section IV.A, supra.

516 See section IV.A. Cf. Intermediary Definitions Adopting Release, 77 FR at 30624.

517 Cf. Intermediary Definitions Adopting Release, 77 FR at 30624; see also Cross-Border Proposing Release, 78 FR at 30993.

518 See Exchange Act rule 3a67-3(e); Intermediary Definitions Adopting Release, 77 FR at 30687.

519 See proposed Exchange Act rule 3a-67-10(c)(1).

520 See section IV.C.2(a) and notes 192-194 (citing comment letters regarding "U.S. person" definition generally), supra.

2. Final Rule

Consistent with the proposal, the final rules require a U.S. person to consider all of its security-based swap positions in its major security-based swap participant threshold calculations.[521] The final rule incorporates the definition of "U.S. person" used in the context of a security-based swap dealer's de minimis calculation.[522]

As discussed above, in our view, the security-based swap positions of a U.S. person exist in the United States and raise, at the thresholds set forth in our further definition of major security-based swap participant, risks to the stability of the U.S. financial system or of U.S. entities, including those that may be systemically important.[523] As noted above, it is the U.S. person as a whole and not merely a foreign branch or office that bears the risk of the security-based swap. Accordingly, it is consistent with our territorial approach to require a U.S. person to include all of its security-based swap positions in its major security-based swap participant threshold calculations.

C. Application of the Major Security-Based Swap Participant Definition to Conduit Affiliates

1. Proposed Approach and Commenters' Views

The proposal would have treated non-U.S. persons acting as "conduits" for their U.S. affiliates the same as any other non-U.S. person for purposes of the major participant analysis, and, as such would have required those persons to include in their major participant threshold

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521 See Exchange Act rule 3a67-10(b)(1).

522 See Exchange Act rule 3a67-10(a)(4) (defining "U.S. person" by referring to rule 3a71-3(a)(4)).

523 See section II.B.2(c); Cf. Exchange Act section 3(a)(67)(B).

calculations only positions with U.S. persons.[524]

The proposal solicited comment regarding whether a non-U.S. person's major participant analysis should incorporate security-based swaps other than those entered into with U.S. persons.[525] Also, as discussed above, the proposal requested comment on the use of the conduit affiliate concept and the treatment of entities that operate a "central booking system."[526]

As discussed above, two commenters opposed applying the "conduit affiliate" definition to entities that serve as "central booking systems" for a corporate group, noting that the "central booking systems" are used to manage internal risk.[527] The commenters argued that applying the conduit affiliate definition in this manner would tie regulatory requirements to firms' internal risk management practices, and would hamper the firms' ability to manage risk across a multinational enterprise.[528] Another commenter suggested that conduit affiliates are the recipients of a de facto guarantee from their U.S. affiliates and thus should be treated as U.S. persons.[529]

2. Final Rule

The final rule modifies the proposal to require conduit affiliates to include all of their security-based swap positions in their major participant threshold calculations.[530] Consistent with the dealer de minimis rules, a "conduit affiliate" is a non-U.S. affiliate of a U.S. person that

524 Cross-Border Proposing Release, 78 FR at 31006. See id. at 31006 n.356 (acknowledging that such treatment differed from the CFTC's proposal and citing CFTC's proposed cross-border guidance).

525 Id. at 31036.

526 See section IV.D.1, supra.

527 See id..

528 See section IV.D.1, supra, notes 309 and 311 (citing SIFMA/FIA/FSR Letter and CDEU Letter).

529 See section IV.D.1, note 310, supra (citing BM Letter).

530 Exchange Act rule 3a67-10(b)(2).

enters into security-based swaps with non-U.S. persons, or with foreign branches of U.S. banks that are registered security-based swap dealers, on behalf of one or more of its U.S. affiliates (other than U.S. affiliates that are registered as security-based swap dealers or major security-based swap participants[531]), and enters into offsetting transactions with its U.S. affiliates to transfer risks and benefits of those security-based swaps.[532]

After careful consideration and as discussed in the context of the dealer de minimis exception, we believe that requiring such conduit affiliates to include their positions in their major participant threshold calculations is consistent with our statutory anti-evasion authority and necessary or appropriate to help ensure that non-U.S. persons do not facilitate the evasion of major participant regulation under the Dodd-Frank Act. Absent a requirement that conduit affiliates include their positions in the threshold calculations, a U.S. person may be able to evade registration requirements under the Dodd-Frank Act by participating in arrangements whereby a non-U.S. person engages in security-based swap activity outside the United States on behalf of a U.S. affiliate that is not a registered security-based swap dealer or major security-based swap participant. The U.S. person could enter into offsetting transactions with the non-U.S. affiliate, thereby assuming the risks and benefits of those positions.[533] Requiring conduit affiliates to

[531] As noted in the discussion of conduit affiliate in the context of the application of dealer de minimis exception, the "conduit affiliate" definition does not encompass persons that engage in such offsetting transactions solely with U.S. persons that are registered with the Commission as security-based swap dealers or major security-based swap participants because we believe the registered status of the U.S. person mitigates evasion concerns. See note 313, supra.

[532] See section IV.D.2, supra; Exchange Act section 3a67-10(a)(1) (incorporating the "conduit affiliate" definition used in the dealer de minimis rule).

[533] See Exchange Act section 30(c); section II.B.2(d), supra. In noting that this requirement is consistent with our anti-evasion authority under section 30(c), we are not taking a position as to whether such activity by a conduit affiliate otherwise constitutes a "business in security-based swaps without the jurisdiction of the United States." See note 315, supra.

include their positions in their major participant threshold calculations will help guard against evasion of major participant regulation and the risk that such entities could pose to the U.S. financial system.[534]

In this context, as in the dealer context, we recognize the significance of commenters' concerns that the "conduit affiliate" concept may impede efficient risk management procedures, such as the use of central booking entities.[535] As in the context of the de minimis exception to the dealer analysis, the "conduit affiliate" definition serves as a prophylactic anti-evasion measure, and we do not believe that any entities currently act as conduit affiliates in the security-based swap market, particularly given that a framework for the comprehensive regulation of security-based swaps did not exist prior to the enactment of Title VII, suggesting that market participants would have had no incentives to use such arrangements for evasive purposes.

Moreover, we believe that commenter concerns may be mitigated by certain features of the major participant analysis and that, to the extent risk mitigation procedures such as "central booking systems" are impacted by the final rules on conduit affiliates, such anticipated impact is appropriate given the purpose of the major participant definition to identify entities that may pose significant risk to the market. As discussed in the Intermediary Definitions Adopting

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We recognize that not all structures involving conduit affiliates may be evasive in purpose. We believe, however, that the anti-evasion authority of Exchange Act section 30(c) permits us to prescribe prophylactic rules to conduct without the jurisdiction of the United States, even if those rules would also apply to a market participant that has been transacting business through a pre-existing market structure established for valid business purposes, so long as the rule is designed to prevent possible evasive conduct. See Cross-Border Proposing Release, 78 FR at 30987; see also section II.B.2(d) and note 316, supra (discussion of anti-evasion authority).

534 Consistent with the approach we are taking in the dealer context, the rule under the major participant analysis requires a conduit affiliate to count all of its positions. See section IV.D.2 and note 312, supra. It is not limited to the conduit affiliate's positions that are specifically linked to offsetting positions with its U.S. affiliate because the correspondence between positions and their offsets may not be one-to-one, such as due to netting.

535 See note 311, supra (citing SIFMA/FIA/FSR Letter and CDEU Letter).

Release, we believe the major participant thresholds are high enough that they will not affect entities, including centralized hedging facilities, of any but the largest security-based swap users.[536] We would not expect that centralized hedging facilities would generally hold positions at the level of the major participant thresholds.[537] Further, the first test in the major security-based swap participant definition, which calculates whether a person maintains a "substantial position," excludes positions held for hedging or mitigating commercial risk.[538] In the Intermediary Definitions Adopting Release, we explained that the exclusion includes hedging on behalf of a majority-owned affiliate, such as a centralized hedging facility.[539] We believe this exclusion in the first test of the major participant definition is likely to lessen the impact that the conduit affiliate rules will have on centralized hedging facilities.[540]

In addition to these features of the major security-based swap participant definition that we anticipate will mitigate the impact of the conduit affiliate rules on risk mitigation practices, we believe the focus of the major participant definition on the degree of risk to the U.S. financial

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536 See Intermediary Definitions Adopting Release, 77 FR at 30671-72 and n.914 (explaining that, for cleared security-based CDS, a person would have to write $200 billion notional of CDS protection to meet the relevant $2 billion threshold for potential future exposure).

537 We note that of the five non-U.S. domiciled entities that we expect to perceive the need to engage in the major security-based swap participant calculation threshold analysis (see section V.H.2(a), infra), none appear to have any U.S.-based affiliates.

538 See Exchange Act rule 3a67-1(a)(2)(i).

539 See Intermediary Definitions Adopting Release, 77 FR at 30675-76.

540 We also note that the third test of the major participant definition, rule 3a67-1(a)(2)(iii), which only applies to "highly leveraged financial entities," excludes centralized hedging facilities acting on behalf of a non-financial entity from the definition of financial entity. To the extent commenters expressed concern that the conduit affiliate rules would affect financial entities and their risk mitigation procedures, this exclusion for centralized hedging facilities is designed to limit that impact. However, to the extent that an entity is not able to use the exclusion and falls within the definition of a highly leveraged financial entity, we believe that requiring such positions to be included is consistent with the focus of the major participant definition. Cf. CDEU Letter at 1 (stating that financial and non-financial end-users should be subject to the same cross-border requirements); IIB Letter at 22 (noting that many financial institutions that do not enter into CDS for dealing purposes still enter into them for hedging purposes).

system justifies regulation of certain entities that perform this function if they maintain positions at a level that may pose sufficient risk to trigger the major participant definition, regardless of the nature of their security-based swap activity.

For the foregoing reasons, we believe that the final rules regarding conduit affiliates are necessary or appropriate to prevent the evasion of any provision of the amendments made to the Exchange Act by Title VII and appropriately target potentially evasive scenarios that present the level of risk that the major security-based swap participant definition is intended to address.[541]

D. Application to Other Non-U.S. Persons

The proposed rules would have required a non-U.S. person to include in its major security-based swap participant analysis all positions with U.S. persons, including foreign branches of U.S. banks.[542] A non-U.S. person would not have had to include its security-based swap positions with non-U.S. person counterparties, even if such positions were guaranteed by another person.[543] A few commenters criticized the proposed requirement that a non-U.S. person include its positions with foreign branches of U.S. banks in its calculation thresholds.[544] Regarding the treatment of a non-U.S. person whose positions with non-U.S. persons are guaranteed by a U.S. person, one commenter supported our proposed approach not to require the

541 See section IV.D.2, supra.

542 See Cross-Border Proposing Release, 78 FR at 31031 (explaining that the "U.S. person" definition applies to the entire person, including its branches and offices that may be located in a foreign jurisdiction and, as such, the potential impact in the United States due to a non-U.S. counterparty's default would not differ depending on whether the non-U.S. counterparty entered into the security-based swap transaction with the home office of a U.S. bank or with a foreign branch of a U.S. bank).

543 See proposed Exchange Act rule 3a67-10(c)(2).

544 See SIFMA/FIA/FSR Letter at A-19 to A-20 (noting that the requirement may provide an incentive for non-U.S. persons to limit trading with foreign branches of U.S. persons and differs from the CFTC guidance); IIB Letter at 12 (noting that the requirement that non-U.S. person include its positions with foreign branches of U.S. persons in its major participant calculation is inconsistent with the proposed requirement in the de minimis context and the CFTC guidance).

person whose position is guaranteed to include such guaranteed positions in its calculation,[545] while other commenters requested that such entities be treated as U.S. persons.[546] The final rules applying the major participant definition to non-U.S. persons are tailored to address the market impact and risk that we believe a person's security-based swap positions would pose to the U.S. financial system.

1. Positions with U.S. Persons Other than Foreign Branches of U.S. Banks

(a) Proposed Approach and Commenters' Views

As noted above, the proposed rules would have required a non-U.S. person to include in its major security-based swap participant threshold calculations all positions with U.S. persons, including foreign branches of U.S. banks.[547] The proposal stated that requiring non-U.S. persons to include their positions with U.S. persons, as defined in the proposal, would "provide an appropriate indication of the degree of default risk proposed by such non-U.S. person's security-based swap positions to the U.S. financial system," by accounting for such non-U.S. person's outward exposures to U.S. persons.[548] One commenter objected to the proposal's approach to look to the U.S.-person status of a clearing agency when a non-U.S. person enters into a security-based swap that is cleared and novated through a clearing agency.[549] In the proposal, we explained that we would consider the clearing agency as the non-U.S. person's counterparty and because the clearing agency is a U.S. person we would require such novated security-based swap

545 See SIFMA/FIA/FSR Letter at A-10 to A-11 (stating that a guaranteed non-U.S. person does not have the necessary "requisite jurisdictional nexus" to be classified as a U.S. person, and thereby supporting the Commission's proposal to address the risk of such guarantees through the attribution process in the major security-based swap participant requirements); note 209, supra.

546 See note 207 (citing AFR Letter I and BM Letter).

547 See Cross-Border Proposing Release, 78 FR at 31031.

548 See id. at 31030 n.612.

549 See CME Letter at 2-3.

to be included in the non-U.S. person's major security-based swap participant calculation threshold calculations.[550] The commenter objected, arguing that the location of clearing should be irrelevant for purposes of determining major security-based swap participant status.[551] Although some commenters took issue with the scope of the "U.S. person" definition, as described above, commenters did not otherwise address this specific requirement within the application of the major security-based swap participant definition.

(b) Final Rule

The final rule, like the proposal, generally requires that non-U.S. persons (apart from the conduit affiliates, which are addressed above)[552] include in their major security-based swap participant threshold calculations their positions with U.S. persons.[553]

Generally requiring non-U.S. persons to consider their security-based swap positions with U.S. persons (except for positions with foreign branches of registered security-based swap dealers, as discussed below) will help ensure that persons whose positions are likely to pose a risk to the U.S. financial system at the relevant thresholds are subject to regulation as a major security-based swap participant.[554] Security-based swap positions involving a U.S.-person counterparty exist within the United States by virtue of being undertaken with a counterparty that is a U.S. person. For these reasons, positions entered into with U.S. persons are likely to raise, at

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550 See Cross-Border Proposing Release, FR 78 at 31030 n.612.

551 CME Letter at 3 (explaining that the requirement will discourage market participants from clearing through a clearing agency in the United States).

552 See section V.C, supra.

553 See Exchange Act rule 3a67-10(b)(3)(i).

554 See Cross-Border Proposing Release, 78 FR at 31030 (explaining that the risk to the U.S. financial system would be measured by calculating a non-U.S. person's aggregated outward exposures to U.S. persons, meaning what such non-U.S. person owes, or potentially could owe, on its security-based swaps with U.S. persons).

the thresholds set forth in our further definition of major security-based swap participant, risks to the stability of the U.S. financial system or of U.S. entities, including those that may be systemically important.[555]

While we considered one commenter's concern that the location of clearing should not be relevant for purposes of determining a non-U.S. person's major security-based swap participant status,[556] we continue to believe that, as such positions are cleared through a U.S.-person clearing agency, they exist within the United States and create risk in the United States of the type the major security-based swap participant definition is intended to address.[557] We note, in response to commenters' opinions about the risk-mitigating effects of central clearing, and the additional level of rigor that clearing agencies may have with regards to the process and procedures for collecting daily margin, that the final rules further defining "substantial position" provide that the potential future exposure associated with positions that are subject to central clearing by a registered or exempt clearing agency is equal to 0.1 times the potential future exposure that would otherwise be calculated.[558] This treatment reflects our view that clearing the security-based swap substantially mitigates the risk of such positions but cannot eliminate such risk.[559] We believe that this previously adopted provision may provide additional incentives for market participants to clear their positions through registered or exempt clearing agencies, and that the requirement to include such positions in the major security-based swap participant threshold

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555 Cf. section 3(a)(67)(B) of the Exchange Act.

556 See CME Letter, supra, note 549.

557 See section II.B.2(c), supra.

558 This results in a 90 percent discount on the notional exposure under the security-based swap. See Exchange Act rule 3a67-3(c)(3)(i)(A); Intermediary Definitions Adopting Release, 77 FR at 30670.

559 See Intermediary Definitions Adopting Release, 77 FR at 30670.

calculations should not discourage market participants from clearing positions through U.S.-based clearing agencies.

2. Positions with Foreign Branches of U.S. Banks

(a) Proposed Approach and Commenters' Views

As noted above, the proposal would have required non-U.S. persons to include their positions with U.S. persons in their threshold calculations. This requirement would have extended to positions with foreign branches of U.S. banks.[560] Two commenters criticized the proposal's requirement that a non-U.S. person would need to include positions with foreign branches of U.S. banks.[561] One of these commenters suggested that the Commission adopt the CFTC policy, which set forth an exception generally permitting a non-U.S. person that is a non-financial entity to exclude from its calculation positions with foreign branches of U.S. banks that are registered swap dealers.[562] One of the commenters suggested that if the Commission did not allow all non-U.S. persons to exclude transactions with foreign branches of U.S. banks from their calculation, the Commission should at least adopt the approach taken by the CFTC in its cross-border guidance of allowing a non-U.S. person that is a financial entity to exclude transactions,

560 See proposed rule 3a67-10(c)(2).

561 See SIFMA/FIA/FSR Letter at A-19 to A-20 (stating that the proposal would result in disparate treatment of foreign branches of U.S. banks because non-U.S. persons could exclude such transactions from their dealer de minimis threshold calculations but not from their major security-based swap participant threshold calculations, and noting that the proposal differs from the CFTC Cross-Border Guidance, which takes the approach that non-U.S. person financial entities generally should exclude swaps with foreign branches of U.S. swap dealers, subject to certain conditions); IIB Letter at 12 (stating that the same rationale that applies to excluding transactions with foreign branches of U.S. banks in the dealer context should apply in the major security-based swap participant context and that the proposed approach is inconsistent with the CFTC Cross-Border Guidance).

562 See IIB Letter at 12-13 (suggesting that the CFTC's general policy of not counting non-financial entities' swaps with guaranteed affiliates that are swap dealers or foreign branches that are swap dealers reflects an understanding that non-financial entities present less risk than financial entities). Cf. CFTC Cross-Border Guidance at 45324-25.

subject to certain additional conditions, with foreign branches of U.S. banks that are registered security-based swap dealers.[563]

(b) Final Rule

The final rule has been modified from the proposal to require non-U.S. persons (other than conduit affiliates, as discussed above) to count, against their major security-based swap participant threshold calculations, their positions with U.S. persons other than positions with foreign branches of registered security-based swap dealers.[564] The proposal would have required non-U.S. persons to all include their positions with U.S. persons in their threshold calculations, including any positions with foreign branches of U.S. banks.[565]

The final rule permits non-U.S. persons not to count certain positions that arise from transactions conducted through a foreign branch of a counterparty that is a U.S. bank.[566] For this exclusion to be effective, persons located within the United States cannot be involved in

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563 See SIFMA/FIA/FSR Letter at A-20 (stating that the proposal to include transactions with foreign branches in a non-U.S. person's major security-based swap participant threshold calculations may cause non-U.S. persons that would otherwise be considered major security-based swap participants to limit or stop trading with foreign branches of U.S. banks); id. at A-20 to A-21 (noting that the approach differs from the CFTC Cross-Border Guidance with respect to counting such transactions towards the major swap participant threshold); see also IIB Letter at 12-13 (stating that the proposal is inconsistent with the CFTC Cross-Border Guidance, whose exceptions demonstrate an understanding that the risk to the U.S. financial system can be addressed through different means and noting that the proposal may cause non-U.S. counterparties to stop transacting with foreign branches of U.S. banks).

564 See Exchange Act rule 3a67-10(b)(3)(i). Exchange Act rule 3a67-10(a)(2) defines "foreign branch" by referring to Exchange Act rule 3a71-3(a)(2). We note for clarification that the rule described here uses the defined term "transactions conducted through a foreign branch" (as defined in Exchange Act rule 3a71-3(a)(3)) to describe the manner in which the U.S.-person must enter into the position in order for the non-U.S. person counterparty to avail itself of this exception. The non-U.S. person counterparty that is calculating its major security-based swap participant calculation thresholds is entering into the position with the foreign branch of the U.S. person.

565 Proposed Exchange Act rule 3a67-10(c)(2).

566 See Exchange Act rule 3a67-10(b)(3)(i). See also IV.E.2(b) (discussing similar exception in the context of the de minimis analysis).

arranging, negotiating, or executing the transaction.[567] Moreover, the counterparty bank must be registered as a security-based swap dealer,[568] unless the transaction occurs prior to 60 days following the effective date of final rules providing for the registration of security-based swap dealers.[569] Registration of the counterparty U.S. bank would not be required for the exclusion to be effective before then, given that the non-U.S. person would not be able to know with certainty whether the U.S. bank in the future would register with the Commission as a security-based swap dealer.[570]

We believe that the revision to the proposal allowing for an exclusion from counting positions that arise from transactions conducted through foreign branches of registered security-based swap dealers appropriately accounts for the risk in the U.S. financial system created by such positions. In our view, the risk of such positions is lessened when the U.S. bank itself is registered with the Commission as a security-based swap dealer because the U.S. bank, and its transactions, will be subject to the relevant Title VII provisions applicable to security-based swap dealers (for example, margin and reporting requirements).[571] The exception is also consistent

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[567] See Exchange Act rule 3a67-10(b)(3)(i) (using the term "transaction conducted through a foreign branch," which requires that "the security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States," as defined in Exchange Act rule 3a71-3(a)(3)(i)(B)).

[568] See Exchange Act rule 3a67-10(b)(3)(i)(A).

A non-U.S. person would still have to count such positions for purposes of calculating its major security-based swap participant calculation thresholds if the non-U.S. person's counterparty (i.e., the U.S. bank) has rights of recourse against a U.S. person in the position with the non-U.S. person. See Exchange Act rule 3a67-10(b)(3)(ii).

[569] See Exchange Act rule 3a67-10(b)(3)(i)(B).

[570] In other words, this provision will help to avoid requiring non-U.S. persons to speculate whether their counterparties would register, and to face the consequences of their speculation being wrong.

[571] See section IV.E.2(b) and note 373 (discussing that the risk of such positions is mitigated in part because the foreign branch of a registered security-based swap dealer will be subject to a number of Title VII regulatory requirements).

with our application of the dealer de minimis exception in our final rule, which requires non-U.S. persons, other than conduit affiliates, to include in their de minimis threshold calculations dealing transactions with U.S. persons other than the foreign branch of a registered security-based swap dealer (or for a temporary period of time prior to 60 days prior to the effectiveness of the dealer registration rules).[572]

The final rule should help mitigate concerns that non-U.S. persons will limit or stop trading with foreign branches of U.S. banks for fear of too easily triggering major security-based swap participant registration requirements under Title VII. Moreover, the inclusion of this exception in our final rule addresses comments expressing concern that non-U.S. persons would have to include positions with foreign branches of U.S. banks in their major security-based swap participant threshold calculations.[573] We also note that the exception reduces divergence between our major participant threshold calculation and that outlined in the CFTC's guidance, as requested by commenters.[574]

3. Positions of Non-U.S. Persons that are Subject to Recourse Guarantees by a U.S. Person

(a) Proposed Approach and Commenters' Views

The proposal would have not required a non-U.S. person to count towards its major security-based swap participant calculation thresholds, those positions that it entered into with non-U.S. persons, regardless of whether the counterparty to the position has a right of recourse

572 See Exchange Act rule 3a71-3(b)(1)(iii)(A); section IV.E.2(b), supra.

573 See note 561, supra.

574 See notes 562 and 563, supra. Although our inclusion of this exception brings us closer to the general policy set forth by the CFTC, our approaches are not entirely identical, as the CFTC includes certain additional inputs for non-U.S. persons that are financial entities that we have determined not to incorporate in our final rule. See CFTC Cross-Border Guidance, 78 FR at 45326-27.

against a U.S. person under the security-based swap.[575] To address the risk posed by the existence of a recourse guarantee against a U.S. person, the proposal would have required that all security-based swaps entered into by a non-U.S. person and guaranteed by a U.S. person be attributed to such U.S. person guarantor for purposes of determining such U.S. person guarantor's major security-based swap participant status.[576]

As noted above, one commenter supported the Commission's proposed approach not to require a non-U.S. person whose positions with other non-U.S. persons are subject to a recourse guarantee from a U.S. person, to include such guaranteed positions in its own major participant threshold calculations, expressing support for using the major security-based swap participant attribution requirements to address the risk posed to the U.S. markets by such guarantees.[577] Two commenters argued that non-U.S. persons whose positions are guaranteed by U.S. persons should be treated as U.S. persons for purposes of the major participant threshold calculations, which would require them to include all their positions in their major participant threshold calculations.[578] Additionally, although commenters did not refer specifically to the application of the major security-based swap participant definition, some commenters requested that the Commission generally harmonize its approach to cross-border activities with that of the

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575 See Cross-Border Proposing Release, 78 FR at 31031 and n.622; see also proposed Exchange Act rule 3a67-10(c)(2). In the proposal, we stated that the non-U.S. person counterparties of a non-U.S. person would bear the risk of loss if that non-U.S. person was unable to pay what it owes, and therefore, that the non-U.S. person need not include in its major participant threshold calculations positions with a non-U.S. counterparty, even if its obligations under the security-based swap are guaranteed by a U.S. person. See Cross-Border Proposing Release, 78 FR at 31031.

576 See id. at 31032.

577 See note 545, supra (citing SIFMA/FIA/FSR Letter).

578 See note 207, supra (citing AFR Letter I and BM Letter).

CFTC.[579]

(b) Final Rule

We are adopting a final rule that requires a non-U.S. person to include in its major security-based swap participant threshold calculations those positions for which the non-U.S. person's counterparty has rights of recourse against a U.S. person.[580] We believe that when a U.S. person guarantees a position, the position exists within the United States and poses risk to the U.S. person guarantor,[581] and the non-U.S. person that enters directly into the position should be required to include the position in its major security-based swap participant threshold calculations. The final rule will also help to apply major participant regulation in a consistent manner to differing organizational structures that serve similar economic purposes, and help avoid disparities in applying major participant regulation to differing arrangements that pose similar risks to the United States.

Accordingly, the final rule modifies the proposal by requiring a non-U.S. person to include in its major security-based swap participant threshold calculations security-based swap positions for which a counterparty to the security-based swap has legally enforceable rights of recourse against a U.S. person, even if a non-U.S. person is counterparty to the security-based

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579 See note 25, supra.

580 See Exchange Act rule 3a67-10(b)(3)(ii). Cf. note 350, supra (noting that this final rule encompasses non-U.S. persons who receive a guarantee from an unaffiliated U.S. person, whereas the final rule under the de minimis exception only encompasses non-U.S. persons who receive a guarantee from a U.S. affiliate).

We note that we have retained the requirement in the proposal that the U.S. guarantor also attribute to itself, for purposes of its own major security-based swap participant threshold calculations, all security-based swaps entered into by a non-U.S. person that are guaranteed by the U.S. person. See Cross-Border Proposing Release, 78 FR at 31032; section V.E.1, infra.

581 See section II.B.2(c), supra.

swap.[582] For these purposes, and as addressed in the context of de minimis exception to the "security-based swap dealer" definition, the counterparty would be deemed to have a right of recourse against a U.S. person if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, a U.S. person in connection with the non-U.S. person's obligations under the security-based swap.

We understand that such rights may arise in a variety of contexts. For example, a counterparty would have such a right of recourse against the U.S. person if the applicable arrangement provides the counterparty the legally enforceable right to demand payment from the U.S. person in connection with the security-based swap, without conditioning that right upon the non-U.S. person's non-performance or requiring that the counterparty first make a demand on the non-U.S. person. A counterparty also would have such a right of recourse if the counterparty itself could exercise legally enforceable rights of collection against the U.S. person in connection with the security-based swap, even when such rights are conditioned upon the non-U.S. person's insolvency or failure to meet its obligations under the security-based swap, and/or are conditioned upon the counterparty first being required to take legal action against the non-U.S. person to enforce its rights of collection.

The terms of the guarantee need not necessarily be included within the security-based swap documentation or even otherwise reduced to writing (so long as legally enforceable rights are created under the laws of the relevant jurisdiction); for instance, such rights of recourse would arise when the counterparty, as a matter of law in the relevant jurisdiction, would have rights to payment and/or collection that may arise in connection with the non-U.S. person's obligations under the security-based swap that are enforceable. We would view the positions of

[582] Exchange Act rule 3a67-10(b)(3)(ii).

a non-U.S. person as subject to a recourse guarantee if at least one U.S. person (either individually or jointly and severally with others) bears unlimited responsibility for the non-U.S. person's obligations, including the non-U.S. person's obligations to security-based swap counterparties. Such arrangements may include those associated with foreign unlimited companies or unlimited liability companies with at least one U.S.-person member or shareholder, general partnerships with at least one U.S.-person general partner, or entities formed under similar arrangements such that at least one U.S. persons bears unlimited responsibility for the non-U.S. person's liabilities. In our view, the nature of the legal arrangement between the U.S. person and the non-U.S. person – which makes the U.S. person responsible for the obligations of the non-U.S. person – is appropriately characterized as a recourse guarantee, absent countervailing factors. More generally, a recourse guarantee is present if, in connection with the security-based swap, the counterparty itself has a legally enforceable right to payment or collection from the U.S. person, regardless of the form of the arrangement that provides such an enforceable right to payment or collection.[583]

In light of comments received and upon further consideration, we believe that the revised approach addresses, in a targeted manner, the risk to the U.S. financial system posed by entities whose counterparties are able to turn to a U.S. person for performance of the non-U.S. person's obligations under a security-based swap position.[584] We believe our final approach strikes an

583 Consistent with the rule implementing the dealer de minimis exception, this final rule clarifies that for these purposes a counterparty would have rights of recourse against the U.S. person "if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap." See Exchange Act rule 3a67-10(b)(3)(ii).

584 We are not requiring a non-U.S. person whose performance with respect to one or more security-based swap positions is subject to a recourse guarantee to include all of its positions with non-U.S. persons towards its major security-based swap participant threshold calculations. We recognize that the CFTC Cross-Border Guidance uses the term "guaranteed affiliate" and states

appropriate balance by directly regulating a non-U.S. person that enters into a position with a counterparty that has a recourse guarantee against a U.S. person, while not treating that non-U.S. person as a U.S. person.[585]

The final rule reflects our conclusion that a non-U.S. person – to the extent it enters into security-based swap positions subject to a recourse guarantee by a U.S. person – enters into security-based swap positions that exist within the United States.[586] The economic reality of such positions is that by virtue of the guarantee the non-U.S. person effectively acts together with a U.S. person to engage in the security-based swap activity that results in the positions, and the non-U.S. person's positions cannot reasonably be isolated from the U.S. person's engagement in providing the guarantee.[587] Both the guarantor and guaranteed entity are involved in the position and may jointly seek to profit by engaging in such security-based swap positions.[588] The final rule echoes our approach, consistent with our approach to regulation of security-based swap dealers that, to the extent that a single non-U.S. person is responsible for positions within the United States (whether by entering into positions with U.S.-person counterparties or for which its non-U.S. person counterparties have recourse against a U.S. person) that rise above the major participant thresholds, the entity that directly enters into such

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the view that such entities should include all of their swap positions in their major swap participant threshold calculations. See CFTC Cross-Border Guidance, 78 FR at 45319. We believe that our final rule, which requires a non-U.S. person to include only those positions with non-U.S. persons where the counterparty has rights of recourse to a U.S. person, appropriately in the context of the security-based swap markets reflects the risk that such positions may create within the United States.

585 Cf. notes 577 and 578 (discussing comment letters).

586 See section II.B.2(c), supra.

587 See section IV.E.1(b), supra (discussing the same point in the context of the application of the de minimis exception).

588 Cf. section IV.E.1(b), supra (discussing a non-U.S. person's dealing activity that is subject to a recourse guarantee).

positions should be required to register as a major security-based swap participant and should be subject to direct regulation as a major security-based swap participant.

The final rules regarding positions for which a counterparty to the position has rights of recourse against a U.S. person aim to apply major participant regulation in similar ways to differing organizational structures that serve similar economic purposes, such as positions entered into by a non-U.S. person that are subject to a recourse guarantee by a U.S. person and security-based swap positions carried out through a foreign branch of a U.S. person.[589] These two differing organizational structures serve similar economic purposes and thus should be treated similarly.

As discussed below, we have maintained the proposed approach requiring a U.S. person to attribute to itself any position of a non-U.S. person for which the non-U.S. person's counterparty has rights of recourse against the U.S. person. This attribution requirement further reflects the focus of the major security-based swap participant definition on positions that may raise systemic risk concerns within the United States.[590] Such positions exist within the United States by virtue of the U.S. person's guarantee, which transmits risk to the U.S. financial system to the extent obligations are owed under the security-based swap by the guaranteed non-U.S. person because the non-U.S. person's counterparty may seek recourse from the U.S. person

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[589] See section IV.E.1(b) and note 341, supra. For the above reasons, we conclude that this final rule is not being applied to persons who are "transact[ing] a business in security-based swaps without the jurisdiction of the United States," within the meaning of section 30(c). See section II.B.2(a), supra. We also believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, U.S. persons would be able to evade major participant regulation under Title VII simply by conducting their security-based swap positions via a guaranteed non-U.S. person, while still being subject to risks associated with those positions.

[590] See section II.B.2(c), supra.

guaranteeing the position.[591] Additionally, the economic reality of this position, even though entered into by a non-U.S. person, is substantially identical, in relevant respects, to a transaction entered into directly by the U.S. guarantor, because a U.S. person is participating directly in the transaction.[592] For these reasons the attribution requirement, which is consistent with our territorial approach and the approach taken in the proposal, reflects the focus of the major security-based swap participant definition.

We note that, consistent with our proposal, we are not requiring non-U.S. persons to include in their major security-based swap participant threshold calculations positions for which they (as opposed to their counterparties) have a guarantee creating a right of recourse against a U.S. person. As we noted in the proposal, non-U.S. persons with a right of recourse against a U.S. person pursuant to a security-based swap do not pose a direct risk to the person providing a guarantee, as that person's failure generally will not trigger any obligations under the guarantee.[593]

E. Attribution

The Cross-Border Proposing Release stated the preliminary view that a person's security-based swap positions in the cross-border context would be attributed to a parent, other affiliate,

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591 See section V.E.1(b), infra.

592 See section V.E, infra.

593 See Cross-Border Proposing Release, 78 FR at 31031 and n.622. We recognize that the CFTC Cross-Border Guidance does set forth the concept that non-U.S. persons should generally include in their major swap participant analysis positions with entities that fall within the CFTC's description of a "guaranteed affiliate," subject to certain exceptions. See CFTC Cross-Border Guidance, 78 FR at 45326-27. We continue to believe, however, consistent with the proposal, that it is not necessary that such non-U.S. person that has rights of recourse against a U.S. person include that position in its major participant threshold calculations because the inability of that non-U.S. person counterparty to pay what it owes pursuant to a security-based swap will generally not pose risk to the U.S. financial system because it will not trigger the obligation of the U.S. guarantor. See Cross-Border Proposing Release, 78 FR at 31031.

or guarantor for purposes of the major participant analysis to the extent that the person's counterparties in those positions have recourse to that parent, other affiliate, or guarantor in connection with the position. Positions would not be attributed in the absence of recourse.[594]

The final rules codify the proposed guidance related to attribution of guaranteed positions to provide clarity to market participants. We continue to believe that a U.S. person should attribute to itself any positions of a non-U.S. person for which the non-U.S. person's counterparty has rights of recourse against the U.S. person, as the position exists within the United States by virtue of the U.S. person guarantor's involvement in the position.[595] Similarly, a non-U.S. person should attribute to itself any positions of a U.S. person for which that U.S. person's counterparty has rights of recourse against the non-U.S. person.[596] We also continue to believe that when a non-U.S. person guarantor has extended a recourse guarantee on the obligations of a U.S. person, those positions exist within the United States by virtue of the guaranteed U.S. person's involvement in the positions as a direct counterparty to the transaction and therefore the positions should be attributed to the non-U.S. person guarantor that is participating in that position through providing its guarantee. The final rules requiring attribution also aim to apply major participant regulation in similar ways to differing organizational structures that serve similar economic purposes, thus helping to ensure that the relevant purposes of the Dodd-Frank Act are not undermined.

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594 See id. 31032 and n.625 (noting that we were not proposing to alter the approach with respect to attribution of guarantees that was adopted by the Commission and the CFTC in the Intermediary Definitions Adopting Release, but rather proposing to apply the same principles in the cross-border context).

595 As discussed above in section V.D.3(b), the economic reality of this position, even though entered into by a non-U.S. person, is substantially identical, in relevant respects, to a transaction entered into directly by the U.S. guarantor.

596 The economic reality of the non-U.S. person's position is substantially identical, in relevant respects, to a position entered into directly by the non-U.S. person.

1. Positions Attributed to U.S. Person Guarantors

(a) Proposed Approach and Commenters' Views

Our preliminary view was that a U.S. person would attribute to itself all security-based swap positions for which it provides a guarantee for performance on the obligations of a non-U.S. person, other than in limited circumstances.[597] We noted that the proposed approach did not alter the guidance regarding attribution that was adopted in the Intermediary Definitions Adopting Release, but proposed an approach in the cross-border context applying the principles set forth in the Intermediary Definitions Adopting Release.[598] This attribution standard was based on our preliminary view that, when a U.S. person acts as a guarantor of a position of a non-U.S. person, the guarantee creates risks within the United States whether the underlying security-based swaps that they guarantee are entered into with U.S. persons or with non-U.S. persons.[599] One commenter argued that attribution is beyond the scope of section 30(c) of the Exchange Act.[600] One commenter argued that our preliminary view regarding attribution for entities guaranteed by U.S. persons would result in "double-counting" and that security-based swap positions should only be attributed to a U.S. guarantor where the direct counterparty to the security-based swap is not otherwise required to count those positions toward its own

597 Cross-Border Proposing Release, 78 FR at 31032 and n.628. See also Cross-Border Proposing Release, 78 FR at 31033 and section V.E.3, infra (discussing limited circumstances where attribution of guaranteed security-based swap positions do not apply).

598 See Cross-Border Proposing Release, 78 FR at 31032 n.624; see also Intermediary Definitions Adopting Release, 77 FR at 30689 n.1132.

599 Cross-Border Proposing Release, 78 FR at 31032.

600 SIFMA/FIA/FSR Letter at A-20 to A-21 (asserting that only the guaranteed entity, which is the direct counterparty to the security-based swap transactions, should include the positions and that to require the guarantor to include the positions goes "beyond the intended limits of Section 30(c) of the Exchange Act").

calculation.[601]

(b) Final Rule

We are adopting rules that codify the preliminary views set forth in our proposal: A U.S. person is required to attribute to itself any security-based swap position of a non-U.S. person for which the non-U.S. person's counterparty to the security-based swap has rights of recourse against that U.S. person.[602] Although we considered commenters' objections to our proposed attribution requirement, we continue to believe that this approach is necessary because, as stated in the Intermediary Definitions Adopting Release, attribution is intended to reflect the risk posed to the U.S. financial system when a counterparty to a position has recourse against a U.S. person.[603] The final rule also includes a note to clarify that a U.S. person is still expected to attribute to itself positions of other U.S. persons for which the counterparty to that U.S. person has a recourse guarantee against the U.S.-person guarantor, as explained in interpretation in the Intermediary Definitions Adopting Release.[604]

We believe that attribution of positions to guarantors is consistent with Exchange Act section 30(c), notwithstanding the argument by one commenter that attribution to a guarantor "extends beyond the intended limits of [s]ection 30(c) of the Exchange Act."[605] As we discuss in

601 See id. at A-20 to A-21.

602 Exchange Act rule 3a67-10(c)(1)(i).

603 See Intermediary Definitions Adopting Release, 77 FR at 30689 n.1135 (stating that the type of attribution addressed at that time may also be expected to raise special issues in the context of guarantees involving security-based swap positions of non-U.S. entities). As noted in the Cross-Border Proposing Release, these risk concerns are the same regardless of whether the underlying security-based swap positions of the non-U.S. person that the U.S. person guarantees are entered into with U.S. persons or non-U.S. persons. See Cross-Border Proposing Release, 78 FR at 31032.

604 See Intermediary Definitions Adopting Release, 77 FR at 30689.

605 See SIFMA/FIA/FSR Letter at A-21.

more detail above, the major security-based swap participant definition focuses on positions that may raise systemic risk concerns within the United States.[606] It is our view that a security-based swap position exists within the United States when it is held by or with a U.S. person, or when a counterparty to the security-based swap has recourse against a U.S. person, as the risks associated with such positions are borne within the United States, and given the involvement of U.S. persons may, at the thresholds established for the major security-based swap participant definition, give rise to the types of systemic risk within the United States that major security-based swap participant regulation is intended to address.[607]

As discussed above, the final rules regarding positions for which a counterparty to the position has rights of recourse against a U.S. person aim to apply major participant regulation to in similar ways to differing organizational structures that serve similar economic purposes, including structures such as security-based swap positions entered into by a non-U.S. person that are subject to a recourse guarantee by a U.S. person and security-based swap positions carried out through a foreign branch.[608]

While we recognize one commenter's concern that attribution would require "double counting" certain positions, we do not agree with that commenter's assertion that the final rule constitutes double-counting, given that both entities assume the risk of the position by either

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606 See section II.B.2(c), supra.

607 See id.

608 See section V.D.3(b), supra. For the above reasons, we conclude that this final rule is not being applied to persons who are "transact[ing] a business in security-based swaps without the jurisdiction of the United States," within the meaning of Exchange Act section 30(c). See section II.B.2(a), supra. We also believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, U.S. persons would be able to evade major participant regulation under Title VII simply by conducting their security-based swap positions via a guaranteed non-U.S. person, while still being subject to the risks associated with those positions.

entering into it directly or by guaranteeing it. Because both entities are involved in the position that poses risk to the U.S. financial system, both entities are required to include it in their respective major participant threshold calculations, at least until the entity whose position is guaranteed is required to register as a major security-based swap participant.[609]

2. Positions Attributed to Non-U.S. Person Guarantors

(a) Proposed Approach and Commenters' Views

In the proposal, we expressed our preliminary view that a non-U.S. person that provides a recourse guarantee for performance on the obligations of a U.S. person should attribute to itself the security-based swap positions of the U.S. person that are subject to guarantees by the non-U.S. person.[610] However, when a non-U.S. person provides a guarantee to another non-U.S. person, the non-U.S. person providing the guarantee would have been required to attribute to itself only those positions for which a U.S. person counterparty has rights of recourse against the non-U.S. person guarantor under the security-based swap. As noted above, one commenter argued that attribution is beyond the scope of section 30(c) of the Exchange Act.[611]

(b) Final Rule

Consistent with our preliminary view, the final rule requires a non-U.S. person to attribute to itself any security-based swap positions of a U.S. person that are subject to a guarantee by the non-U.S. person.[612] In other words, the non-U.S. person guarantor will attribute to itself all security-based swap positions of the U.S. person for which a counterparty of the U.S.

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609 See Exchange Act rule 3a67-10(c)(2)(i).

610 See Cross-Border Proposing Release, 78 FR at 31032-33.

611 See note 600, supra.

612 Exchange Act rule 3a67-10(c)(1)(ii)(A).

person has rights of recourse against the non-U.S. person guaranteeing the position.[613] The rule reflects our view that the guarantee may enable the U.S. person to enter into significantly more security-based swap positions with both U.S.-person and non-U.S. person counterparties than it would be able to absent the guarantee, increasing the risk that such persons could incur, amplifying the risk of the non-U.S. person's inability to carry out its obligations under the guarantee.[614]

Under the final rule, if a U.S. person in a transaction with a non-U.S. person counterparty has rights of recourse against another non-U.S. person under the security-based swap, the non-U.S. person guaranteeing the transaction must attribute the security-based swap to itself for purposes of its major security-based swap participant threshold calculations.[615] We note that, consistent with the rule requiring non-U.S. persons to count positions entered into with U.S. persons, a non-U.S. person that attributes a position of another non-U.S. person to itself does not need to attribute to itself positions arising from a transaction conducted through a foreign branch of the U.S.-person counterparty when the counterparty is a registered security-based swap dealer or positions arising from a transaction conducted through a foreign branch of a U.S.-person counterparty, when the transaction is entered into prior to 60 days following the earliest date on

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613 Exchange Act rule 3a67-10(c)(1)(ii)(A) may be broader than the CFTC Cross-Border Guidance in this context because the final rule requires the non-U.S. person to attribute to itself all the positions of the U.S. person that are guaranteed by the non-U.S. person, whereas the CFTC Cross-Border Guidance states that the non-U.S. person would generally not attribute to itself positions of the U.S. person that it guarantees where the counterparty is another non-U.S. person that is not guaranteed by a U.S. person. See CFTC Cross-Border Guidance at 45326 (stating that a non-U.S. person would generally consider in its own calculation (i.e., attribute to itself) any swap position (of a U.S. or non-U.S. person) that it guarantees in which the counterparty is a U.S. person or a guaranteed affiliate).

614 See Cross-Border Proposing Release, 78 FR at 31032-33.

615 Exchange Act rule 3a67-10(c)(ii)(B).

which registration of security-based swap dealers is first required.[616]

As explained above, we believe that attribution of positions to guarantors is consistent with Exchange Act section 30(c), notwithstanding the argument by one commenter that attribution to a guarantor "goes beyond the intended limits of section 30(c) of the Exchange Act."[617] As we discuss in more detail above, the major security-based swap participant definition focuses on positions that may raise systemic risk concerns within the United States.[618] It is our view that a security-based swap position exists within the United States when it is held by or with a U.S. person, or when it is guaranteed by a U.S. person, as the risks associated with such positions are borne within the United States, and given the involvement of U.S. persons may give rise, at the thresholds established for the major security-based swap participant definition, to the types of systemic risk within the United States that major security-based swap participant regulation is intended to address.[619]

The final rules requiring non-U.S. persons to attribute certain positions to themselves for purposes of calculating their own major security-based swap participant calculation thresholds aims to apply major participant regulation in similar ways to differing organizational structures that serve similar economic purposes. For example, when a U.S. person has rights of recourse against a non-U.S. person, the economic reality of the position is substantially identical, in relevant respects, to a position entered into directly by the non-U.S. person with the U.S. person. The relevant attribution requirements reflect that a non-U.S. person would need to include such

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616 See section V.D.2 (describing exception for transaction conducted through a foreign branch of a registered security-based swap dealer), supra; Exchange Act rule 3a67-10(c)(ii)(B) (incorporating Exchange Act rule 3a67-10(b)(3)(i)(A) and (B)).

617 See SIFMA/FIA/FSR Letter at A-20 to A-21.

618 See section II.B.2(c), supra.

619 See id.

positions were it to enter into them directly.[620]

3. Limited Circumstances Where Attribution of Guaranteed Security-Based Swap Positions Does Not Apply

(a) Proposed Approach and Commenters' Views

The proposal stated our preliminary view that a guarantor would not be required to attribute to itself the security-based swap positions it guarantees, and, therefore, may exclude those positions from its threshold calculations, if the person whose positions it guarantees is already subject to capital regulation by the Commission or the CFTC (for example, by virtue of being regulated as a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, FCMs, brokers, or dealers), is regulated as a bank in the United States, or is subject to capital standards adopted by its home country supervisor that are consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision ("Basel Accord").[621] This preliminary view applied both to U.S. persons and non-U.S. persons that are subject to registration and regulation in the enumerated categories.[622] Our

620 See section V.D.3(b), supra. For the above reasons, we conclude that this final rule is not being applied to persons who are "transact[ing] a business in security-based swaps without the jurisdiction of the United States," within the meaning of section 30(c). See section II.B.2(a), supra. We also believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, non-U.S. persons would be able to evade major participant regulation under Title VII simply by conducting their security-based swap positions by guaranteeing another entity that would then enter into the positions.

621 See Cross-Border Proposing Release, 78 FR at 31033 (explaining that the non-U.S. person must be subject to capital standards that are consistent with the capital standards such non-U.S. person would have been subject to if it was a bank subject to the prudential regulators' capital regulation, i.e., the Basel Accord); see also Intermediary Definitions Adopting Release, 77 FR 30689 (stating that it is not necessary to attribute a person's positions to a parent or other guarantor if the person already is subject to capital regulation by the CFTC or SEC or if the person is a U.S. person regulated as a bank in the United States). Thus, once the person whose position is guaranteed registers as a major security-based swap participant, attribution would no longer be required.

622 See Cross-Border Proposing Release, 78 FR 31033 at n.636.

preliminary view was that such consistent foreign regulatory capital requirements would adequately address the risks arising from such positions, making it unnecessary to separately address the risks associated with guarantees of those same positions.[623] We noted that this approach was consistent with the capital standards of the prudential regulators with respect to foreign banks that are bank holding companies subject to the Federal Reserve Board of Governors' supervision.[624]

One commenter supported our preliminary view that a non-U.S. person's guaranteed positions would not be attributed to the guarantor if the guaranteed non-U.S. person is subject to capital regulation by the Commission, the CFTC, or capital standards in its home jurisdiction that are consistent with the Basel Accord.[625] Another commenter sought clarification that a U.S. guarantor will not be required to attribute transactions of guaranteed entities while the guaranteed person's registration as a major security-based swap participant is pending.[626]

(b) Final Rules

Although the final rules require, in some circumstances, both the guarantor and the guaranteed person to include guaranteed positions in their respective major security-based swap participant threshold calculations, the final rules do not require a guarantor to attribute guaranteed positions to itself when the guaranteed person is subject to capital regulation by the

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623 See id. at 31033-34.

624 See id. at 31033 (citing § 225.2(r)(3) of Regulation Y, which states that "[f]or purposes of determining whether a foreign banking organization qualifies under paragraph (r)(1) of this section: (A) A foreign banking organization whose home country supervisor...has adopted capital standards consistent in all respects with the Basel Accord may calculate its capital ratios under the home country standard...").

625 See SIFMA/FIA/FSR Letter at A-21 to A-22; see also Cross-Border Proposing Release, 78 FR at 31033.

626 See AFGI Letter I at 3 (stating that this clarification would be within the spirit and language of the proposed rules).

Commission or the CFTC (including, but not limited to regulation as a swap dealer, major swap participant, security-based swap dealer, major security-based swap participant, futures commission merchant, broker, or dealer).[627] This codifies our preliminary view.[628] The final rule, moreover, does not require a guarantor to attribute to itself positions that it guarantees when the guaranteed person is regulated as a bank in the United States, or is subject to capital standards adopted by its home country supervisor that are consistent in all respects with the Basel Accord.[629] Consistent with our preliminary view, we believe that consistent foreign regulatory capital requirements would adequately address the risks arising from such positions, making it unnecessary to separately address the risks associated with guarantees of those same positions.[630] We continue to view such regulatory treatment as adequate to address the risks that the attribution requirement is intended to address. We also note that this approach is consistent with the capital standards of the prudential regulators with respect to foreign banks that are bank holding companies subject to the Federal Reserve Board of Governors' supervision.

As noted above, one commenter requested that a U.S. guarantor not be required to attribute to itself a person's positions for which it provides a guarantee while that person's

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627 See Exchange Act rule 3a67-10(c)(2)(i).

628 See Cross-Border Proposing Release, 78 FR at 31032-33, notes 629, 632, and 634.

629 Exchange Act rule § 240.3a67-10(c)(2)(ii) and (iii). See Cross-Border Proposing Release, 78 FR at 31033 (explaining that the non-U.S. person must be subject to capital standards that are consistent with the capital standards such non-U.S. person would have been subject to if it were a bank subject to the prudential regulators' capital regulation, i.e., the Basel Accord); Intermediary Definitions Adopting Release, 77 FR at 30689. This approach generally is consistent with the CFTC Cross-Border Guidance. See CFTC Cross-Border Guidance, 78 FR at 45326 (stating that "where a subsidiary is subject to Basel-compliant capital standards and oversight by a G20 prudential supervisor, the subsidiary's positions would generally not be attributed to a parental guarantor in the computation of the parent's outward exposure under the MSP definition").

630 See Cross-Border Proposing Release, 78 FR at 31033-34.

registration as a major security-based swap participant is pending.[631] Upon further consideration, we believe that it is appropriate to permit a guarantor not to attribute the positions of such entities to itself. This change will mitigate market disruption that may otherwise result due to the prospect of a person intermittently exceeding the major participant threshold when a person that it guarantees is in the process of registering as a major security-based swap participant. This approach is also consistent with the approach under the application of the de minimis exception that allows a person not to count the transactions of its affiliates that are in the process of registering as dealers.[632]

F. Other Issues Related to the Application of the Major Security-Based Swap Participant Definition

1. Threshold for Registration as a Major Security-Based Swap Participant

One commenter commented generally that the threshold for having to register as a major-security-based swap participant is too high.[633] This threshold, however, was adopted in the Intermediary Definitions Adopting Release and is not under consideration in this rulemaking. In addition, the Intermediary Definitions Adopting Release provided that the Commission staff will prepare a report subsequent to the effectiveness of the security-based swap reporting requirements that will examine a number of aspects of our definitional rules and related interpretations, including relevant major security-based swap participant thresholds.[634]

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631 See note 626, supra.

632 See Exchange Act rule 3a67-10(c)(2)(iv) (referring to rule 3a67-8(a)); see also Exchange Act rule 3a71-4 (addressing persons who have exceeded the de minimis thresholds but are in the process of registering); section IV.F.2, supra.

633 BM Letter at 15-16 (stating that the excessively high major participant threshold excludes most market participants, thus leaving large, non-U.S. entities that are active in the market subject only to dealer requirements).

634 See Intermediary Definitions Adopting Release, 77 FR at 30697-30699.

2. Entities that Maintain Legacy Portfolios

The Cross-Border Proposing Release did not address the treatment of legacy portfolios, but we stated in the Intermediary Definitions Adopting Release that "the fact that these entities no longer engage in new swap or security-based swap transactions does not overcome the fact that entities that are major participants will have portfolios that are quite large and could pose systemic risk to the U.S. financial system."[635] Based on this understanding, the Commissions jointly determined that such entities should not be excluded from major participant regulation but explained that the Commissions would pay particular attention to special issues raised by the application of substantive rules to those legacy portfolios.[636]

In the Commission's proposed capital and margin requirements, we proposed exceptions from certain account equity requirements, such as collection of margin, for non-bank security-based swap dealers' and non-bank major security-based swap participants' accounts holding legacy security-based swaps and we requested comment on these proposals.[637] As explained in the Intermediary Definitions Adopting Release, we may entertain requests for relief or guidance on a case-by-case basis.[638] One commenter requested that, at a minimum, the Commission provide flexibility in any requirements that require a person to register as a major security-based swap participant solely due to activity related to its legacy portfolios.[639] With respect to the

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635 Id. at 30691.

636 Id. at 30691 and n.1170.

637 See Exchange Act proposed rules 18a-3(c)(1)(iii)(D) and 18a-3(c)(2)(iii)(C); see also Capital and Margin Proposing Release, 77 FR at 70214, 70247, 70265, 70269-70, 70271-72 (proposed capital, margin and segregation requirements for security-based swap dealers and major security-based swap participants).

638 Intermediary Definitions Adopting Release, 77 FR at 30691.

639 AFGI Letter I at 2 (suggesting that the Commission consider providing an exemption from major security-based swap participant registration for entities that will be required to register solely due to their legacy portfolios, if their legacy positions are expected to decline below the major

activities of financial guaranty insurers, one commenter suggested that amendments made to an existing insured security-based swap or entry into a new security-based swap with the same or a substituted counterparty in connection with loss mitigation or risk reduction efforts, should receive the same regulatory treatment given to legacy portfolio security-based swaps because such security-based swaps do not increase notional exposure.[640]

In the context of the cross-border application of the major security-based swap participant definition, we are maintaining our approach to legacy portfolios as described in the Intermediary Definitions Adopting Release and are not excluding entities that maintain legacy portfolios from the major security-based swap participant definition.[641] Given the foregoing, we are not adopting an exclusion from the cross-border application of the major security-based swap participant definition for entities that maintain legacy portfolios.

G. Foreign Public Sector Financial Institutions and Government-Related Entities

In the Cross-Border Proposing Release, we did not propose to specifically address the treatment of entities such as foreign central banks, international financial institutions, multilateral development banks, and sovereign wealth funds in the context of the major security-based swap participant definition and instead sought comment regarding the types, levels, and natures of

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security-based swap participant threshold within 12 to 14 months of the effective date due to projected run-off or terminations); AFGI Letter II at 2-5; AFGI letter, dated February 18, 2011 ("AFGI Letter V") at 11 (stating that attribution to a financial guaranty insurer is not appropriate when the insurer guarantees a security-based swap obligation of an unaffiliated entity) (incorporated by reference in AFGI Letter I).

640 AFGI Letter I at 3 (stating that such activities, like activities related to legacy swaps, do not constitute new business and that regulators should implement consistent regulatory treatment in this area to reduce exposure resulting from these legacy transactions); AFGI Letter II at 2-3. See also AFGI Letter III at 5 (arguing that an amendment to a legacy account for loss mitigation or credit strengthening without increasing notional exposure should still be considered the legacy account instead of a new security-based swap); AFGI letter, dated July 20, 2011 ("AFGI Letter IV") at 2-4 (supporting exclusion for state-regulated insurers) (incorporated by reference in AFGI Letter I); AFGI Letter V at 3 (same).

641 See Intermediary Definitions Adopting Release, 77 FR at 30691.

security-based swap activity that such organizations regularly engage in in order to allow us to better understand the roles of these organizations in the security-based swap markets.[642]

The final rule defining "U.S. person" (like the proposed definition of that term) specifically excludes several foreign public sector financial institutions and their agencies and pension plans, and more generally excludes any other similar international organization and its agencies and pension plans.[643] As explained in the context of the de minimis exception, certain commenters requested that we take further action to address the application of the dealer definition and its de minimis exception to security-based swap activities involving such organizations.[644] Additionally, we noted that two commenters stated that they should not be subject to the possibility of dealer regulation for comity reasons, on the grounds that they were arms of a foreign government.[645] Commenters did not make arguments specific to the application of the major security-based swap participant definition but articulated their arguments in conjunction with their arguments related to the application of the dealer definition. However, one commenter explained that, though it understands that multilateral development banks do not currently engage in security-based swap at the level that would trigger major security-based swap participant registration, even if they did, regulation would violate their

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642 See Cross-Border Proposing Release, 78 FR at 31034-35. See section IV.C.2(e) and Exchange Act rule 3a71-3(a)(4)(iii) (listing the international organizations that are excluded from the definition of "U.S. person").

643 See section IV.C.2(e), supra.

644 See, e.g., WB/IFC Letter at 2-4, 6-7 (also stating that such organizations should not be required to register as major participants or to clear security-based swaps, and that affiliates of such organizations should be excluded from the "U.S. person" definition); SC Letter at 16-24 (contending that the privileged and immunities afforded such organizations would be violated by their direct regulation as dealers or major participants, or by direct regulation equivalents, and that affiliates of such organizations also are immune from regulation); IDB Letter at 5. See note 420, supra.

645 See note 422, supra.

privileges and immunities.[646]

As discussed in the context of the de minimis exception, it is our view that such issues are outside the scope of this release given that the source of any such privileges and immunities is found outside of the Dodd-Frank Act and the federal securities laws.[647]

Similar to the discussion in the context of the de minimis exception, commenters also stated that non-U.S. persons should not have to count their security-based swap positions involving these organizations against their major security-based swap participant threshold calculations on the basis that counting such positions would constitute the impermissible regulation of such organizations.[648] As discussed in the context of the de minimis exception, we do not agree with the suggestion that counting a person's positions with such organizations against the major participant calculation thresholds – when otherwise provided for by the rules – involves the regulation of such organizations.[649] Requiring a person to count, against their major participant calculation thresholds, the person's positions involving such an international organization as counterparty simply reflects the application of the federal securities laws to that person and its positions, and does not constitute the regulation of the international organization.[650] A person's security-based swap positions with such an international organization are considered the same, for purposes of applying the major participant calculation thresholds and other Title VII requirements, as a position with some other non-U.S. person counterparty.

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646 See SC Letter at 16.

647 See section IV.H.2, supra.

648 See section IV.H.2, supra; SC Letter at 18-19; WB/IFC Letter (incorporating SC Letter).

649 See IV.H.2, supra.

650 See id.

H. Economic Analysis of Final Rules Regarding "Major Security-Based Swap Participants"

These final rules and guidance regarding the cross-border implementation of the application of the definition of major security-based swap participants will affect the costs and benefits of major security-based swap participant regulation by determining which positions will be counted against a market participant's major security-based swap participant calculation thresholds.[651] The cross-border rules have the potential to be important in determining the extent to which the risk mitigation and other benefits of Title VII are achieved, by identifying those market participants with sufficiently large exposures to raise the types of systemic risk concerns that the major security-based swap participant definition was intended to address.[652]

As discussed in the context of the cost-benefit analysis of the application of the de minimis exception in the cross-border context, commenters addressed cost-benefit issues from a variety of perspectives, including arguing that cost-benefit principles warranted greater harmonization with the approaches taken by the CFTC or foreign regulators.[653] Commenters, however, did not separately address cost-benefit issues related to the application of the major security-based swap participant definition.

We have taken economic effects into account in adopting these final cross-border rules and providing guidance. Because security-based swap contracts are associated with complex risks and the markets are highly interconnected, we believe that positions that exist within the United States, which are most likely to expose the U.S. financial system to financial risk, should

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651 See section IV.I, supra; see also Intermediary Definitions Adopting Release, 77 FR at 30666 (explaining that in developing the rules further defining "substantial position," we were mindful of the costs associated with regulating major participants and considered cost and benefit principles as part of that analysis).

652 See section III.A, supra.

653 See section IV.I, supra.

generally be included in the major security-based swap participant threshold calculations. At the same time, we recognize that the cross-border application of Title VII has the potential to reduce liquidity within the U.S. market to the extent it increases the costs of entering into security-based swaps or provides incentives for particular market participants to avoid the U.S. market to operate wholly outside the Title VII framework.[654]

As addressed in the analysis of the costs and benefits of our application of the de minimis rule, the application of the major security-based swap participant definition implicates two types of costs and benefits: assessment costs and programmatic costs and benefits.[655] First, certain current and future participants in the security-based swap market will incur assessment costs in connection with determining whether they fall within the "major security-based swap participant" definition and thus would have to register with the Commission.

Second, the registration and regulation of some entities as major security-based swap participants will lead to programmatic costs and benefits arising as a consequence of the Title VII requirements that apply to registered major security-based swap participants.[656]

We discuss these costs and benefits associated with the final rules more fully below. We also discuss the economic impact of certain potential alternatives to the approach taken in the final rules.

1. Programmatic Costs and Benefits

(a) Cost-benefit Considerations of the Final Rules

Exchange Act rule 3a67-10 will permit market participants to exclude certain of their positions from their major security-based swap participant threshold calculations, and thus may

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654 See id., supra.

655 See id., supra.

656 See Cross-Border Proposing Release, 78 FR at 31139.

cause particular entities that engage in security-based swap transactions not to be regulated as major security-based swap participants. The rules accordingly may be expected to affect the programmatic costs and benefits associated with the regulation of major security-based swap participants under Title VII, given that those costs and benefits are determined in part by which persons will be regulated as major security-based swap participants.[657]

As discussed in the context of the application of the de minimis exception, this does not mean that there is a one-to-one relationship between a person not being a "major security-based swap participant" as a result of these cross-border rules, and the resulting change to programmatic benefits and costs.[658] In practice, we believe that these rules will focus the regulation of major security-based swap participants on those market participants whose security-based swap positions may expose the U.S. financial system to the levels of risk we identified as warranting regulation as a major security-based swap participant in the Intermediary Definitions Adopting Release, or on the prevention of evasion. To the extent that a person's positions within the United States remain below these thresholds, we believe that regulating it as a major security-based swap participant under Title VII would be less likely to produce the types of programmatic benefits that Title VII was intended to address. In other words, these requirements will direct the application of the major security-based swap participant definition – which itself is the product of cost-benefit considerations – towards those entities whose security-based swap positions are most likely to pose the type and level of risk to the U.S. financial system that Title VII was intended to mitigate.

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657 See Intermediary Definitions Adopting Release, 77 FR at 30727.

658 See section IV.I.1(a) and note 431, supra (discussing various fixed and variable costs).

As such, the rules reflect our assessment and evaluation of programmatic costs and benefits:

- Positions of U.S. persons – Requiring U.S. persons, as defined in the final rules (including the foreign branches of such persons), to include all of their positions in their major participant threshold calculations, addresses risks that these positions pose to the U.S. financial system.

- Positions guaranteed by U.S. persons – Requiring non-U.S. persons to include in their major security-based swap participant threshold calculations all their positions that are guaranteed by a U.S. person, where their counterparties have recourse to the guarantor, reflects both the economic reality of the position – that the position exists within the United States – and addresses the risks posed to the U.S. financial system by the positions of such persons that are guaranteed by U.S. persons.[659]

- Positions with U.S.-person counterparties – Requiring non-U.S. persons to include their positions with counterparties that are U.S. persons, unless the positions are with a foreign branch of a registered security-based swap dealer, addresses risks to the U.S. financial system arising from positions entered into with U.S. persons.[660]

- Attribution of certain positions to guarantors of performance under a security-based swap – Requiring guarantors of performance under security-based swaps to attribute to themselves, for purposes of their own major security-based swap participant threshold calculations, positions that they guarantee, addresses risks that guarantees pose to the U.S. financial system. To the extent that the guarantee involves a position within the United

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659 See Exchange Act rule 3a67-10(b)(3)(ii); section V.D.3, supra.

660 See Exchange Act rule 3a67-10(b)(3)(i); section V.D.1; see also note 437, supra (discussing rationale for this limitation in context of de minimis exception).

States or brings a position within the United States, our final rules would typically require attribution to the guarantor. These requirements are intended to help ensure that positions that pose risks to the U.S. financial system are included in the guarantor's major participant threshold calculations.[661]

- Positions subject to anti-evasion provisions – Requiring conduit affiliates to include all of their positions in their major participant threshold calculations addresses, in a targeted manner, the potential for evasion of the major security-based swap participant requirements of Title VII.[662] As noted above we are adopting a definition of "conduit affiliate" that excludes affiliates of registered security-based swap dealers and major security-based swap participants to avoid imposing costs on registered persons in situations that would not appear to implicate the types of evasion concerns that the conduit affiliate definition is intended to address.

In short, these final rules apply the major security-based swap participant definition – which itself reflects cost-benefit considerations[663] – to cross-border security-based swap positions in a way that directs the focus of major participant regulation toward those entities whose security-based swap positions may expose the U.S. financial system to the levels of risk we identified as warranting regulation as a major security-based swap participant.

(b) Evaluation of Programmatic Impacts

In defining "substantial position" and "substantial counterparty exposure" as part of the Intermediary Definitions Adopting Release, we sought to capture persons whose security-based

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661 See Exchange Act rule 3a67-10(c); section V.E, supra.

662 See Exchange Act rule 3a67-10(b)(2); section V.C, supra.

663 See Intermediary Definitions Adopting Release, 77 FR at 30666 (explaining that in developing the rules further defining "substantial position," we were mindful of the costs associated with regulating major participants and considered cost and benefit principles as part of that analysis).

swap positions pose sufficient risk to counterparties and the markets generally that regulation as a market participant was warranted, without imposing costs of Title VII on those entities for which regulation currently may not be justified in light of the purposes of the statute.[664] As discussed above in the context of the dealer analysis, we estimated in the Intermediary Definitions Adopting Release that, under those rules, approximately 12 entities had outstanding positions large enough that they would likely carry out threshold calculations and that fewer than five entities, and potentially zero, would ultimately be required to register as major security-based swap participants.[665] Those estimates provide a baseline against which the Commission can analyze the programmatic costs and benefits and assessment costs of the final rules applying the major security-based swap participant definition to cross-border activities.

We believe the methodology used in the Intermediary Definitions Adopting Release also

[664] See id. at 30724-25.

[665] See id. at 30727 and note 1529; section III.A.2.

That methodology determined that an entity that margins its positions would need to have security-based swap positions approaching $100 billion to reach the levels of potential future exposure required to meet the substantial position threshold, even before accounting for the impact of netting, while an entity that clears its security based swaps generally would need to have positions approaching $200 billion. We believed that it was reasonable to assume that most entities that will have security-based swap positions large enough to potentially cause them to be major participants in practice will post variation margin in connection with those positions that they do not clear, making $100 billion the relevant measure. The available data from 2011 showed that only one entity had aggregate gross notional positions (i.e., aggregate buy and sell notional positions) in single-name CDS exceeding $100 billion, and three other entities had aggregate gross notional positions between $50 and $100 billion. We explained, however, that an entity's positions reflecting single-name credit protection sold to its counterparties, as opposed to purchased, may be expected to be a more key determinant of potential future exposure under those rules. The data showed that zero entities had more than $100 billion in positions arising from selling single-name credit protection and that only two entities had between $50 and $100 billion arising from such positions. See id. at 30727, 30734 and note 1529.

In the Intermediary Definitions Adopting Release, we noted that to the extent that an entity's security-based swap positions are not cleared or associated with the posting of variation margin, security-based swap positions of $20 billion may lead to sufficient potential future exposure to cause the entity to be a major participant, though we believed that few, if any, entities would have a significant number of such positions. The data indicated that only 32 entities have notional CDS positions in excess of $10 billion. See id. at note 1529.

is appropriate for considering the potential programmatic costs and benefits associated with the final cross-border rules. This methodology particularly can help provide context as to how rules regarding the cross-border application of the definition of major security-based swap participant may change the number of entities that must register as major security-based swap participants, and thus help provide perspective regarding the corresponding impact on the programmatic costs and benefits of Title VII. Applying that methodology to 2012 data regarding the single-name CDS market suggests that under these final rules five or fewer entities may have to register as major security-based swap participants – a number that is consistent with our estimates in the Intermediary Definitions Adopting Release.[666]

The factors that are described in more detail in section IV.I.1(b) regarding the application of the de minimis exception are also relevant to and may impact the programmatic benefits and costs associated with the implementation of the cross-border application of the major security-based swap participant definition. Those factors include limitations of the methodology and data used, the impact of the not yet finalized rules implementing Title VII entity-level and transaction-level requirements applicable to major security-based swap participants, market participants' modifications to their business structure or practices in response to the final rules, and the impact on market participants of other regulatory requirements that are analogous to the

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666 See note 444, supra (noting that the data on which the methodology is based has been updated).

Consistent with the methodology used in the Intermediary Definitions Adopting Release, the 2012 data indicated that two entities had aggregate gross notional positions (i.e., aggregate buy and sell notional positions) in single-name CDS exceeding $100 billion. Applying the principles reflected in these final rules regarding the counting of positions against the major security-based swap participant thresholds suggests that two entities would have aggregate gross notional positions in single name CDS exceeding $100 billion. No additional entities would be required to register as a result of aggregation. Based on this data, we believe that it is reasonable to conclude that five or fewer entities ultimately may register as major security-based swap participants.

major security-based swap participant requirements.[667]

In general, however, and consistent with our territorial approach, we believe that these rules are targeted appropriately and do not apply major security-based swap participant regulation to those entities whose positions have a more limited impact on the U.S. financial system and hence whose regulation as a major security-based swap participant under Title VII would be less linked to programmatic benefits (i.e., non-U.S. persons that engage in security-based swap transactions entirely, or almost entirely, outside the United States with non-U.S. persons or with certain foreign branches), while applying major participant regulation to those entities whose positions would be more likely to produce programmatic benefits under Title VII. The nexus between specific aspects of these requirements and the programmatic costs and benefits also is addressed below in connection with our consideration of various alternatives to the approach taken in the final rules.

Finally, as discussed in the context of the de minimis exception, we recognize that the U.S. market participants and positions regulated under Title VII are a subset of the overall global security-based swap market and that shocks to risk or liquidity arising from a foreign entity's positions outside the United States may spill into the United States.[668] We also have considered these spillovers in connection with our analysis of the effects of these final cross-border rules on efficiency, competition, and capital formation.[669]

2. Assessment Costs

The analysis of how these cross-border rules will affect the assessment costs associated with the "major security-based swap participant" definition is related to the assessment cost

667 See section IV.I.1(b), supra.

668 See section IV.I.1(b), supra (describing spillover risks).

669 See section VIII.B, infra.

analysis described in the Intermediary Definitions Adopting Release,[670] but must also account for certain issues specific to these cross-border rules. While in certain regards those assessment costs can more readily be estimated than the programmatic effects discussed above, the assessment costs associated with the cross-border application of the Title VII major participant requirements will be considerably less significant than those programmatic effects.

The Intermediary Definitions Adopting Release addressed how certain market participants could be expected to incur costs in connection with their determination of whether they have a "substantial position" in security-based swaps or pose "substantial counterparty exposure" created by their security-based swaps, which is necessary for determining whether they are major security-based swap participants.[671] In that release we estimated that as many as 12 entities would likely perceive the need to perform these calculations, given the size of their security-based swap positions.[672] We preliminarily believed that entities that perceive the need to perform the threshold calculations as a result of the proposed rules and guidance set forth in the Cross-Border Proposing Release would incur only relatively minor incremental costs to those described in the Intermediary Definitions Adopting Release.[673] Based on the estimate that no more than 12 entities would perceive the need to engage in the analysis of whether they are a major security-based swap participant, we estimated that the total legal costs associated with evaluating the various elements of the definition may approach $360,000.[674]

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670 See Intermediary Definitions Adopting Release, 77 FR at 30733-36.

671 See id. at 30734-36.

672 See id. at 30734.

673 See Cross-Border Proposing Release, 77 FR at 31141.

674 See Intermediary Definitions Adopting Release, 77 FR at 30736. We also noted in that release that if 32 entities were to perform the analysis, the market wide legal costs would total $960,000. See id. at 30736 n. 1539; see also note 665, supra (noting that if an entity did not clear or post

As discussed in the context of the de minimis exception, application of these cross-border rules can be expected to affect the assessment costs that market participants will incur. In part, certain non-U.S. persons may be expected to incur personnel costs and legal costs – beyond the legal costs addressed as part of the Intermediary Definitions Adopting Release – associated with analyzing these cross-border rules and developing systems and procedures to assess which transactions would have to be counted against the major security-based swap participant calculation thresholds (or with the purpose of avoiding positions that pose risk to the United States financial system that would be sufficient to meet the applicable thresholds). On the other hand, while certain market participants also would incur additional legal costs associated with the major security-based swap participant determination (i.e., the assessment of whether particular positions should be included in the major participant threshold calculations) addressed in the Intermediary Definitions Adopting Release, the application of the cross-border rules may reduce the number of entities that incur such legal costs.[675]

In adopting these rules we estimate the assessment costs that market participants may incur as a result. As discussed below, however, these costs in practice may be mitigated in large part by steps that market participants already have taken in response to other regulatory initiatives, including compliance actions taken in connection with the requirements applicable to swaps.

(a) Legal Costs

The implementation of these cross-border rules in some circumstances has the potential

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variation margin, $20 billion in notional CDS positions may be sufficient exposure to cause the entity to be a major participant and that 32 entities have notional CDS positions exceeding $10 billion).

675 See section IV.I.2, supra.

to change the legal costs identified in the Intermediary Definitions Adopting Release, including by adding new categories of legal costs that non-U.S. persons may incur in connection with applying the major security-based swap participant definition in the cross-border context.

Legal costs related to the cross-border application of major security-based swap participant definition – As discussed in the Intermediary Definitions Adopting Release, certain market participants will incur assessment costs related to the analysis of whether their positions rise to the levels set by the major security-based swap participant definition. For purposes of that release, we assumed that entities with aggregate gross notional single-name CDS positions exceeding $25 billion may identify a need to perform the major participant analysis.[676] Based on that figure, we estimated that 12 entities would perceive the need to perform the major participant analysis.[677]

Under the final rules described above, available data from 2012 indicates that approximately nine persons will have relevant positions exceeding $25 billion, and we continue to believe that firms whose positions exceed this amount will be likely to perform the major participant threshold analysis.[678] Of those nine, five entities are not domiciled in the United States. Consistent with our view in the proposing release, we expect that non-U.S. firms in this set will incur additional costs beyond those described in the Intermediary Definitions Adopting Release. These additional costs would arise due to information that non-U.S. market participants

[676] See Intermediary Definitions Adopting Release, 77 FR at note 1529.

[677] Based on data as of December 2011, in that release we found that 1 entity had aggregate gross notional positions from bought and sold credit protection exceeding $100 billion, 4 entities had aggregate gross notional single-name CDS positions exceeding $50 million, and 12 entities had aggregate gross notional CDS positions exceeding $25 billion. See id. at 30734 n. 1529.

[678] See section III.A.1, supra. The difference between this and our previous estimate of 12 entities reflects changes in security-based swap activity since the Intermediary Definitions Adopting Release and the final rules' treatment of positions between non-U.S. persons in the absence of guarantees from U.S. persons.

would have to collect and maintain in order to calculate the size of positions that count towards the major participant thresholds. Consistent with our analysis in the Intermediary Definitions Adopting Release, we believe that it is reasonable to conclude that at least some entities with security-based swap positions approaching the major participant thresholds are likely to seek legal counsel for interpretation of various aspects of the rules pertaining to the major participant definition.[679] Though the costs associated with obtaining such legal services would vary depending on the facts and circumstances regarding an entity's positions, we believe that $40,000 is a reasonable estimate of the upper end of the range of the costs of obtaining the services of outside counsel in undertaking the legal analysis of the entity's status as a major security-based swap participant.[680]

Legal costs related to systems analysis – As noted in the assessment cost analysis related to the de minimis exception (and in addition to the estimates in the Cross-Border Proposing Release), we believe that it is reasonable to conclude that those five entities not domiciled in the United States may have to incur one-time legal expenses related to the development of systems and analysis expenses – discussed below – to identify which of their security-based swap positions potentially must be counted for purposes of the major security-based swap participant

679 See Intermediary Definitions Adopting Release, 77 FR at 30735.

680 The average cost incurred by such entities in connection with outside counsel is based on staff experience in undertaking legal analysis of status under federal securities laws. The staff believes that costs associated with obtaining outside legal counsel relating to such determinations range from $20,000 to $40,000 depending on the complexity of the entity. See id. at 30735-36 n. 1537 (estimating the upper bound of such costs at $30,000). We note that the additional $10,000 added to the estimate in the Intermediary Definitions Adopting Release is intended to account for the additional complexity that non-U.S. persons may face in performing the analysis.

These estimates do not reflect a new category of costs arising from the cross-border rules. They instead are a revision of a category of previously identified costs that market participants may incur in obtaining legal services to assist in performing the major participant analysis, using newer data and reflecting only positions that are counted under the final cross-border rules.

analysis, consistent with these cross-border rules. As in the dealer context, this additional cost estimate reflects the fact that the development of such systems and procedures must address cross-border rules that require accounting for factors such as whether an entity's security-based swaps are subject to guarantees from U.S. persons, whether its counterparties are U.S. persons, and, specific to the major security-based swap participant analysis, whether the entity must attribute the position to itself pursuant to the attribution rules. As in the analysis of assessment costs related to the dealer definition, we estimate that such legal costs would amount to approximately $30,400 per entity, and that those five entities would incur total costs of approximately $152,000.[681]

(b) Costs Related to New Systems, Analysis, and Representations

Transaction-monitoring systems – The elements introduced by the final cross-border rules may cause certain non-U.S. persons to implement systems to identify whether their positions exceed the major security-based swap participant calculation thresholds. Such systems may reflect the need for non-U.S. persons to: (i) identify whether their counterparties are "U.S. persons"; (ii) determine whether their positions with U.S. persons arise from transactions conducted through a foreign branch (which itself requires consideration of whether their counterparty is a "foreign branch") and – of those – determine which positions involve a foreign branch of a U.S. bank that itself is a registered security-based swap dealer; (iii) determine whether particular positions are subject to a recourse guarantee against a U.S. person; and (iv) evaluate the applicability of the attribution rules.[682] Our estimates for the required systems are the same in the major participant analysis as they are in the dealer analysis: one-time

681 See section IV.I.2(a) and note 460 (addressing calculations of costs), supra.

682 We do not believe that a potential major security-based swap participant will need to use any systems to determine if it is a "conduit affiliate." See note 462, supra.

programming costs of $14,904 and ongoing annual systems costs of $16,612 per entity.[683]

Analysis of counterparty status, including representations – As discussed in the context of the de minimis exception, non-U.S. market participants would be likely to incur costs arising from the need to assess the potential U.S.-person status of their counterparties, which we would typically expect to be dealers, and in some cases to obtain and maintain records related to representations regarding their counterparty's U.S.-person status.[684] We anticipate that non-U.S. persons are likely to review existing information about their counterparties to assess whether those counterparties are U.S. persons.[685] Non-U.S. persons at times may also request and maintain representations from their dealer and non-dealer counterparties to help determine or confirm their counterparties' status.[686] Accordingly, as in the discussion of dealer assessment costs, in our view, such assessment costs primarily would encompass one-time costs to review and assess existing information regarding counterparty domicile, principal place of business, and other factors relevant to potential U.S.-person status, as well as one-time costs associated with requesting and collecting representations from counterparties.[687] The costs associated with representations in the context of the major participant analysis would be one-time costs of

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683 See section IV.I.2(b) and note 464, supra.

684 See Exchange Act rule 3a67-10(a)(4) and (3) (incorporating the definitions of "U.S. person" "transaction conducted through a foreign branch," including provisions permitting reliance on representations); see also section IV.I.2(b) and note 465, supra (noting that non-U.S. market participants may seek representations as to whether positions arise from transactions conducted through a foreign branch of a U.S. bank that is registered as a security-based swap dealer and also noting our understanding that few, if any, U.S. persons may participant in the single-name CDS market through their foreign branches).

685 See section IV.I.2(b), supra.

686 See id.

687 See section IV.I.2(b) and note 466, supra (explaining that determination of U.S.-person status generally will not vary over time absent changes involving corporate reorganizations).

approximately $24,200 per firm.[688]

Monitoring of counterparty status – Also as addressed in the context of the de minimis exception, market participants may be expected to adapt their systems to monitor the status of their counterparties for purposes of future security-based swap activities, which would allow market participants to maintain records of counterparty status for purposes of conducting the major participant assessment.[689] Market participants also may need to monitor for the presence of information that may indicate that the representations they have received are outdated or otherwise are not valid.[690] The costs associated with adapting the systems described above to monitor the status of their counterparties for purposes of their future security-based swaps would

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688 See section IV.I.2(b), supra. The cumulative estimate is based on the same methodology and SIFMA Management & Professional Earnings in the Securities Industry 2013 data that we used to estimate these one-time costs for dealers. See note 467, supra. With respect to major security-based swap participants, we conservatively assume that each of the non-U.S. firms will have 30 single-name CDS counterparties (based on data indicating that the five non-U.S. firms persons with total single-name CDS positions in 2012 exceeding $25 billion all had fewer than 45 counterparties in connection with single-name CDS, which produces an estimate of 15 hours of compliance staff time and 15 hours of legal staff time per firm. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2013 (modified by the 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 staff estimates that the average national hourly rate for a senior compliance examiner is $217 and that the average national hourly rate for an in-house attorney is $380; this leads to a cumulative estimate of $9,000 per firm for such costs.

Consistent with the Cross-Border Proposing Release, moreover, this estimate is further based on estimated 40 hours of in-house legal or compliance staff's time (based on the above rate of $380 per hour for an in-house attorney) to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be incorporated into standardized trading documentation used by market participants. This leads to an estimate of $15,200 per firm for such costs. See section IV.I.2(b) and note 467, supra.

689 We also recognize that the final rules requiring attribution may impose certain additional monitoring costs on market participants whose position in a security-based swap is guaranteed by another entity and on the entities that provide the guarantee. We anticipate that the guarantors may receive reports from the market participants whose position is guaranteed in order to allow the guarantors to monitor the amount of such positions for purposes of determining whether the positions attributed to the guarantor rise to the level that would require them to register as a major security-based swap participant.

690 See section IV.I.2(b) and note 469, supra.

be the same as the costs in the dealer analysis: one-time costs of approximately $12,436.[691]

Summary of systems, analysis, and representation costs – The summary of costs that certain non-U.S. market participants would incur in connection with systems, analysis of counterparty status and representations in connection with these cross-border rules would be approximately $51,500 in one-time costs[692] and $16,612 in estimated annual ongoing costs.[693] Based on our estimate, subject to the limitations associated with the use of data analysis discussed above, that five non-U.S. domiciled entities will incur these assessment costs, we estimate that the total one-time industry-wide costs associated with establishing such systems would amount to approximately $257,500 and total ongoing costs would amount to approximately $83,100.

(c) Overall Considerations Related to Assessment Costs

In sum, we believe that the effect of these final cross-border rules would be an increase over the amounts that otherwise would be incurred by certain non-U.S. market participants, both in terms of additional categories of legal costs and in terms of the need to develop certain systems and procedures. As discussed in the context of the assessment costs applicable to the dealer analysis, we believe that requiring certain non-U.S. persons to incur such assessment costs is an unavoidable adjunct to the implementation of a set of rules that are

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691 See section IV.I.2(b) and note 468 (noting that parties may structure their relationships in a way that will not require a separate representation in conjunction with each individual position) and 470, supra (describing calculations for this estimate).

692 Consistent with the above discussion, the estimated one-time costs of $51,500 represent: the costs to establish a system to assess the status of their positions under the definitions and other provisions specific to these cross-border rules ($14,904); the costs related to the assessment of counterparty status, including costs of assessing existing information and of requesting and obtaining representations, as well as costs of related procedures ($24,200); and the costs for monitoring the status of their counterparties for purposes of their future security-based swap activities ($12,436). See section IV.I.2(b) and note 471, supra.

693 See section IV.I.2(b), supra.

appropriately tailored to apply the "major security-based swap participant" definition under Title VII to a global security-based swap market in a way that yields the relevant benefits associated with the regulation of major participants and achieves the benefits of Title VII.[694] The benefits of Title VII's regulatory requirements applicable to major security-based swap participants could be undermined if a significant portion of positions held by non-U.S. persons that impose risk on the U.S. financial system were excluded from the Title VII framework. In certain respects, however, decisions embedded in these final rules are designed to avoid imposing assessment costs upon market participants.[695]

As explained in the context of the analysis for dealers, we recognize that our estimates of assessment costs may result in an overestimation as such costs may be tempered to the extent that market participants' assessments correspond to the assessments they otherwise would follow due to other regulatory requirements or business practices, particularly with respect to assessments they may have made regarding the U.S.-person status of their counterparties.[696]

Also as noted in the dealer discussion, we acknowledge that certain aspects of the final rules may differ from those of the CFTC, which may result in higher costs for market participants, but we believe that such differences are justified and we discuss those differences in the substantive discussions of the specific rules.[697] We also recognize other factors that may impact the assessment costs for potential major security-based swap participants, such as the possibility that certain market participants will choose to restructure their business to avoid

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694 See section IV.I.2(c), supra.

695 See id.

696 See id.

697 See id.

major security-based swap participant regulation.[698]

3. Alternative Approaches

As discussed above, the final rules incorporate a number of provisions designed to focus Title VII major security-based swap participant regulation upon those persons whose security-based swap positions may raise the risks within the United States that the major participant definition was intended to address.[699]

In adopting these final rules we have considered alternative approaches suggested by commenters, including the economic effects of following such alternative approaches. In considering the economic impact of potential alternatives, we have sought to isolate the individual alternatives to the extent practicable, while recognizing that many of those alternatives are not mutually exclusive.[700]

We further have considered such potential alternatives in light of the methodologies discussed above, by assessing the extent to which following particular alternatives would be expected to increase or decrease the number of entities that ultimately would be expected to be regulated as major security-based swap participants under the final rules, as well as the corresponding economic impact. Analysis of the available data would tend to suggest that various alternative approaches suggested by commenters would not produce any changes in the numbers of market participants that may have to be regulated as major security-based swap participants. These results are subject to the above limitations, however, including limitations regarding the ability to quantitatively assess how market participants may adjust their future activities in response to the rules we adopt or for independent reasons. Accordingly, while such

698 See id.

699 See section V.A, supra.

700 Cf. section IV.I.3, supra.

analyses provide some context regarding alternatives, their use as tools for illustrating the economic effects of such alternatives is limited.

(a) Security-based Swap Positions Held by Foreign Branches of U.S. Banks

As with the final rules in the context of the de minimis exception, the final rules applying the major security-based swap participant definition require U.S. banks to count all positions of their foreign branches against the major participant calculation thresholds, even when the counterparty is a non-U.S. person or another foreign branch of a U.S. person. The proposed definition of "U.S. person" plays a central role in the application of Title VII in the cross-border context, directly affecting which positions a person must include in its major security-based swap participant threshold calculations and ultimately, the number of entities that will register as major security-based swap participants. An alternative approach would permit U.S. persons not to include the positions of their foreign branches in their major security based swap participant calculation thresholds. As discussed above, we believe our approach to U.S. persons as described above, is consistent with our overall territorial approach to the application of Title VII requirements to the cross-border security-based swap market, because it requires that major security-based swap participant calculation thresholds include the positions of such persons that are most likely to cause risk to the U.S. financial system at the threshold levels set in the major security-based swap participant definition.[701] For the reasons discussed above, we believe that it is appropriate for a U.S. person to include in its calculation thresholds positions conducted through foreign branches to the same extent as other positions help by U.S. persons.[702]

As in the dealer analysis, using the 2012 data to assess the impact associated with this

701 See section II.B.2(c), supra.

702 See section V.B.2, supra.

alternative does not indicate a change to our estimate that up to five entities potentially would register as major security-based swap participants, and the analysis is subject to the limitations discussed in the context of the dealer analysis.[703] Adopting an alternative approach that does not require foreign branches to count their positions with non-U.S. persons could incentivize U.S. persons to execute higher volumes through their branches.[704]

(b) Positions of Non-U.S. Persons for which the Counterparty has Rights of Recourse Against a U.S. Person

The final rules require a non-U.S. person to count, against its major security-based swap participant calculation thresholds, positions for which the non-U.S. person's performance in connection with the transaction is subject to a recourse guarantee against a U.S. person. Although the proposal instead would have treated such guaranteed affiliates like any other non-U.S. persons, we believe that this provision is appropriate for the reasons discussed above, including the fact that such recourse guarantees pose risks to the U.S. financial system via the guarantor.[705]

This aspect of the final rules reflects a middle ground between commenter views, as is discussed above regarding the approach taken in the dealer analysis.[706] The same two alternatives that are presented in the analysis of alternatives to the approach to the dealer final rules are relevant to the discussion of the application of the major security-based swap participant definition – one alternative in which the final rules do not address guarantees at all, and one in which (based on the concept of a de facto guarantee) all affiliates of a U.S. person should have to

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[703] See section IV.I.3(a) and note 477, supra.

[704] See section IV.I.3(a), supra (discussing the same issue in the dealer context).

[705] See section IV.I.3(b), supra (addressing similar discussion in the context of the dealer analysis).

[706] See id., supra.

count their security-based swap positions against the calculation thresholds, with a potential exception if they demonstrate to the market that there will be no guarantee.[707] A third alternative and the approach taken in the proposal would require the non-U.S. person to include in its threshold calculations only those positions with U.S. persons that are not guaranteed but would require those positions that are guaranteed to be attributed to the U.S. person guarantor for purposes of its own threshold calculations.

The analysis of the first two alternatives discussed in the context of the application of the dealer requirements above also applies in the context of applying the major security-based swap participant definition.[708] The third alternative, which is the approach taken in the proposal, may have reduced programmatic benefits by increasing the likelihood that, even when a person exceeds the thresholds by virtue of its own positions, which exist within the United States by virtue of the U.S. person guarantor, it will not be subject to direct regulation as a major participant.[709] Under the proposed approach, only the U.S. person guarantor would have counted the positions for which the non-U.S. person's counterparty had rights of recourse against the U.S. person, meaning that such positions would not be accounted for in the major participant threshold calculations of the entity that directly enters into the positions. The economic reality of such positions is that by virtue of the guarantee the non-U.S. person effectively acts together with a U.S. person to engage in the security-based swap activity that results in the positions, and the non-U.S. person's positions cannot reasonably be isolated from the U.S. person's

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707 See id.

708 See section IV.I.3(b), supra (explaining that not requiring non-U.S. persons to include positions for which their counterparty has a recourse guarantee against a U.S. person could incentivize U.S. persons to use such guarantees, whereas an approach that requires an affiliate of a non-U.S. person to include all of its positions in its major security-based swap participant calculation thresholds may negatively impact liquidity).

709 See section II.B.2(c), supra.

engagement in providing the guarantee.[710] The final rule reflects this economic reality by requiring the non-U.S. person whose position is guaranteed to include such positions in its major security-based swap participant threshold calculations.[711]

For the foregoing reasons, we believe that the approach taken in the final rules is appropriate. We note that an assessment of the data regarding the first alternative does not indicate a change in the number of entities that may be expected to register as major security-based swap participants.[712] Due to data limitations that prevent us from identifying which individual transactions of non-U.S. persons are subject to guarantees by U.S. persons and data limitations preventing us from obtaining information about the single-name security-based swap transactions of non-U.S. domiciled persons for single-name CDS involving a non-U.S. reference entity, the available data does not enable us to assess the second and third alternatives.[713]

(c) Positions of Conduit Affiliates

The final rules require conduit affiliates to count all of their security-based swap positions in their major security-based swap participant threshold calculations. The available data does not permit us to identify which market participants would be deemed conduit affiliates.[714] As explained in the corollary discussion in the dealer analysis, we believe the alternative of not requiring such entities to count their positions would remove a tool that should help to deter market participants from seeking to evade regulation.

710 See section V.D.3(b), supra.

711 See id.

712 See section IV.I.3(b) and note 481 (explaining that the data does not enable us to identify which positions of non-U.S. persons are subject to guarantees by U.S. persons).

713 See section IV.I.3(b) and notes 481 and 482, supra.

714 See section IV.I.3(c), supra.

As addressed in the dealer analysis another alternative to address such evasive activity could be to narrow the inter-affiliate exception, such as by making the exception unavailable when non-U.S. persons enter into positions with their U.S. affiliates.[715] While this alternative may be expected to reduce costs to such entities, we believe the final rules will achieve comparable anti-evasion purposes with less cost and disruption.[716]

(d) Positions of Non-U.S. Persons with Foreign Branches of U.S. Banks and Certain Other Counterparties

The final rules require non-U.S. persons to include their positions arising from transactions conducted through foreign branches of U.S. banks unless the U.S. bank is registered as a security-based swap dealer. This reflects a change from the proposal, which would have required non-U.S. persons to include all positions with foreign branches of U.S. banks without exception. The final approach, as in the context of the dealer analysis, reflects a middle ground between commenter views, which provided two alternatives: that all positions arising from transactions conducted through foreign branches be counted or that no such position be counted against a non-U.S. person's major security-based swap participant calculation thresholds.[717] Adopting the first alternative requiring non-U.S. persons to include all positions with foreign branches would raise the potential for disparate impacts upon U.S. persons with foreign branches, along with associated concerns about liquidity impacts.[718] Adopting the second alternative excluding all such positions from being counted, could incentivize U.S. market participants that are not registered as dealers to execute higher volumes of security-based swaps

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715 See id.

716 See id.

717 See section IV.I.3(d), supra.

718 See id.

through their foreign branches, resulting in higher levels of risk being transmitted to the United States without the risk-mitigating attributes of having a registered dealer involved in the position.[719]

The available data related to these alternatives is subject to the limitations discussed above and does not indicate a change to our assessment of the number of entities that may be expected to register as major security-based swap participants.[720]

Another alternative approach would require non-U.S. persons to include in their major security-based swap participant threshold calculations those positions for which they have rights of recourse against a U.S. person or their positions with counterparties that are conduit affiliates.[721] We believe that the positions of such non-U.S. persons do not transmit risk to the United States in the same way as if the potential major security-based swap participant is the entity whose performance is guaranteed by a U.S. person because the default of the non-U.S. person who holds the right of recourse against the U.S. person guarantor will not impact the outward exposure of the U.S. person or the non-U.S. person whose position is guaranteed. While these alternatives may potentially increase programmatic benefits associated with Title VII major participant regulation, they would also likely increase assessment costs by requiring such non-U.S. persons to evaluate and track whether they have a right of recourse against a U.S. person, potentially reducing liquidity available to U.S. corporate groups that provide guarantees to non-U.S. persons.[722] We note that, under the final rules regarding guaranteed positions, the entity

719 See id.

720 See id.

721 See note 576 (describing CFTC approach) and note 189 (describing comments suggesting to treat guaranteed entities as U.S. persons), supra.

722 See section IV.I.3(d).

involved in the position with the closest connection to the United States, the non-U.S. person whose position is guaranteed, as well as the U.S. guarantor itself, will already be including the position in each of their calculations. Thus we believe such benefits would be more attenuated than those associated with the final rules' approach of directly counting the positions of such guaranteed non-U.S. persons. Accordingly, we do not believe these alternatives would generate significant additional programmatic benefits.

(e) Attribution

i. Attribution to U.S. Persons

Our final attribution approach requires U.S. persons to include, for purposes of their major security-based swap participant calculation thresholds, those positions for which a non-U.S. person's counterparty has rights of recourse against the U.S. person.

An alternative approach would not require a U.S. person to include such positions in its threshold calculations. This alternative potentially reduces the programmatic costs and benefits of major participant regulation because it would reduce the number of positions that U.S. guarantors would include in their calculations. By reducing the costs associated with providing guarantees, such an alternative could reduce the barriers to participation in the security-based swap market faced by participants who might benefit from risk sharing afforded by security-based swap positions but cannot credibly provide sufficient information for their counterparties to assess creditworthiness. We further believe that such an approach would only reduce the assessment costs associated with major participant regulation to the extent that U.S. guarantors do not have private incentives in place to collect information about positions they guarantee.

As noted in section V.D.3, however, we believe it is important to account for the risk to the U.S. financial system transmitted by such guaranteed positions. Ensuring that a U.S. person counts positions of potentially several entities whose counterparties have rights of recourse

against it, where each of those entities may be individually below the major participant threshold, will generate the types of benefits that Title VII was intended to produce. The benefits of including these positions are significant because, through the U.S. guarantor, these positions expose the U.S. financial system to the type of risk that the definition of major security-based swap participant is intended to address.

ii. Attribution to Non-U.S. Persons

Under the final rules a non-U.S. person must include security-based swap positions of a U.S. person for which that person's counterparty has rights of recourse against the non-U.S. person, and security-based swap positions of another non-U.S. person that are with a U.S.-person counterparty who has rights of recourse against the non-U.S. person that is the potential major security-based swap participant.

An alternative approach to these requirements would be to not require non-U.S. persons to include such positions, even when those positions are entered into by U.S. persons or when a U.S. person has a right of recourse against them under those positions. Not requiring these positions to be attributed to the non-U.S. person could reduce assessment costs for non-U.S. persons and potentially result in fewer non-U.S. persons ultimately registering as major security-based swap participants. This alternative potentially improves risk sharing by U.S. persons who must rely on guarantees in order to participate in the security-based swap market by reducing the costs incurred by non-U.S. person guarantors. It likely would, however, also reduce programmatic benefits to the extent that non-U.S. persons that guarantee positions within the United States of multiple entities, each of which is below the major participant threshold, are not required to include such positions in their own calculations.

Such non-U.S. persons who provide guarantees ultimately bear the risk of positions they guarantee, and the aggregate risk exposure of the U.S. financial system to a non-U.S. person

guarantor varies more directly with the notional amount of positions involving U.S. persons that are guaranteed than with the number of entities to which it provides guarantees. As a result, the Commission believes it is appropriate to apply attribution requirements that treat non-U.S. person guarantors of positions to which U.S. persons are counterparties as if they were direct counterparties. With respect to guarantees provided by non-U.S. persons to U.S. persons, the Commission believes it is appropriate to attribute guaranteed positions because U.S. persons bear the risk that non-U.S. person guarantors will be unable to fulfill obligations under the guarantees they provide.

(f) Positions Cleared Through a Clearing Agency in the United States

The final approach requires non-U.S. persons to include in their major participant threshold calculations those positions that are entered into with U.S. persons, including positions that are cleared through a registered clearing agency in the United States. An alternative raised by a commenter suggested that the location of clearing not be relevant for purposes of determining whether a non-U.S. person is a major security-based swap participant.[723] This alternative would ignore the risk that is posed to the U.S. financial system by positions cleared through a U.S.-person clearing agency, and would be inconsistent with the general approach that all positions with U.S. counterparties should be counted towards the major security-based swap participant threshold calculation. For this reason, we believe the alternative would ignore important programmatic benefits that are incorporated in the final approach.

(g) Foreign Government-Related Entities

Several commenters suggested that foreign government-related entities, such as sovereign wealth funds and MDBs, should be excluded from the U.S. person, security-based swap dealer,

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[723] See section V.B.2 and note 549, supra. See also section VIII.A, infra.

and major security-based swap participant definitions.[724] By potentially capturing fewer major security-based swap participants, this alternative approach would correspondingly decrease the programmatic costs and benefits associated with Title VII regulation of major security-based swap participants. We believe that security-based swap transactions entered into by these types of foreign government-related entities with U.S. persons pose the same risks to the U.S. security-based swap markets as transactions entered into by entities that are not foreign-government related. Moreover, as noted above,[725] we understand that foreign government-related entities rarely enter into security-based swap transactions (as opposed to other types of swap transactions) in amounts that would trigger the obligation to register as a major security-based swap participant. To the extent that such entities do enter into security-based swaps with U.S. persons, however, we believe such requiring such entities to include those positions in their major participant threshold calculations will generate programmatic benefits, as such positions introduce risk into the United States of the type title VII intended to address.

VI. Substituted Compliance Procedural Rule

A. Proposed Approach and Commenters' Views

The Cross-Border Proposing Release addressed a range of substantive issues regarding the potential availability of substituted compliance, whereby a market participant could satisfy certain Title VII obligations by complying with comparable foreign requirements. These included issues regarding which requirements might be satisfied via substituted compliance, and regarding the showings necessary to obtain a substituted compliance order from the Commission.

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[724] See section IV.H.2 and note 420 (addressing comments in de minimis context and citing WB/IFC Letter SC Letter and IDB Letter at 5), supra.

[725] See section V.G, supra.

The release also proposed to amend the Commission's Rules of General Application to establish procedures for considering substituted compliance requests, similar to the procedures that the Commission uses to consider exemptive order applications under section 36 of the Exchange Act.[726] Among other aspects, proposed Exchange Act rule 0-13 would require that substituted compliance applications be in writing and include any supporting documentation necessary to make the application complete – "including information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor compliance with such rules" – and that applications cite applicable precedent.[727] The proposed rule also stated that the Commission may choose to publish requests in the Federal Register, and stated that requestors may seek confidential treatment.[728] We preliminarily concluded that those

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[726] See generally Cross-Border Proposing Release, 78 FR at 31087-88.

[727] See proposed Exchange Act rule 0-13(a), (e). Proposed Exchange Act rule 0-13 further would provide that applications must comply with Commission rule 0-3 (regarding the filing of materials with the Commission). Under the proposal, all applications would be submitted to the Commission's Office of the Secretary electronically or in paper format, and in the English language. If an application is incomplete, the Commission may request that the application be withdrawn unless the applicant can justify why supporting materials have not been submitted and undertakes to submit promptly the omitted materials. The Commission would not consider hypothetical or anonymous requests for a substituted compliance order. The proposed rule further addressed issues regarding contact information, amendments to the application, the review process, and potential hearings regarding the application. See proposed Exchange Act rule 0-13; see also Cross-Border Proposing Release, 78 FR at 31087-88.

[728] See proposed Exchange Act rule 0-13(a), (h). The proposal stated that requests for confidential treatment would be permitted to the extent provided under 17 CFR 200.81. See proposed Exchange Act rule 0-13(a); Cross-Border Proposing Release, 78 FR at 31087-88. Under 17 CFR 200.81, persons submitting exemptions and related relief may also request that it be accorded confidential treatment for a specified period of time not exceeding 120 days. If the Commission staff determines that the request is reasonable and appropriate it will be granted and the letter or other communication will not be made available for public inspection or copying until the expiration of the specified period. If the staff determines that the request for confidential treatment should be denied, the staff shall advise the person making the request and the person may withdraw the letter or other communication within 30 days.

proposed procedures would provide sufficient guidance regarding the submission process.[729] We also solicited comment regarding the sufficiency of the guidance provided by the proposed rule, and regarding whether foreign regulatory authorities should be able to submit substituted compliance requests.[730]

One commenter raised concerns that the proposed availability of confidential treatment "would foreclose any public comment, debate or analysis of the applicant's claims about the foreign regulatory regime, leading to an industry-led process." That commenter urged us to disallow confidential treatment of applications, and to invite public comment as foreign jurisdictions are considered for comparability."[731]

Commenters also asked for greater clarity regarding the information to be provided in connection with substituted compliance requests.[732] Commenters also asked that the Commission coordinate with the CFTC and foreign regulators in making substituted compliance determinations.[733]

Other commenters addressed a related issue regarding whether foreign regulators could

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[729] See Cross-Border Proposing Release, 78 FR at 31088.

[730] See id.

[731] See AFR Letter I at 11-12.

[732] See FOA Letter at 4 (stating that the proposed requirement that an application include supporting documentation that the applicant believes necessary for the Commission to make the determination "puts the burden of interpretation wholly on the applicant"; requesting additional guidance regarding the information needed to accompany requests, and greater specificity to ensure "that the applications it receives address a similar range of compliance issues and contain a similar amount of supporting detail"); SIFMA/FIA/FSR Letter at A-38 (urging the Commission "to provide a more granular and detailed framework regarding the considerations relevant to evaluating substituted compliance requests").

[733] See, e.g., FOA Letter at 8 (requesting that the Commission and the CFTC coordinate in making substituted compliance determinations and that the Commissions consider whether to accept joint submissions from foreign regulators or foreign market participants); CEDU Letter at 2 (stating that the Commission should work closely with the CFTC "when determining whether substituted compliance is applicable with respect to a particular jurisdiction").

submit substituted compliance requests. Proposed Exchange Act rule 3a71-5, regarding substituted compliance for foreign security-based swap dealers, specified that such requests may be filed by a foreign security-based swap dealer or group of dealers. A number of commenters took the contrasting position that foreign regulators should be able to submit substituted compliance requests.[734] Some commenters further stated that such requests solely should be submitted by foreign regulators.[735] Two commenters particularly emphasized the importance of the Commission's substituted compliance assessments taking into account foreign enforcement and supervisory practices.[736]

B. Final Rule

In large part, we expect to address issues regarding the availability of substituted compliance as part of future rulemakings, in conjunction with considering the cross-border application of the relevant substantive rules. As discussed above, we believe that it is appropriate to address issues regarding the cross-border application of the substantive requirements under Title VII in conjunction with considering the final rules to implement those substantive requirements, as substituted compliance potentially will constitute an integral part of the final approach toward cross-border application.

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734 See, e.g., SIFMA/FIA/FSR Letter at A-36 ("Foreign regulators are often best placed to describe their rules and provide information for the purposes of a comparability analysis. Such an approach would also allow for a more efficient use of resources.").

735 See EC Letter at 3 (suggesting that "the review of a foreign regime should be conducted in cooperation solely with the relevant foreign regulators or legislators, as opposed to firms" to avoid duplication or confusion); ESMA Letter at 3.

736 See AFR Letter I at 12 (supporting ability to reject or withdraw substituted compliance determinations based on the failure of a foreign regime to exercise supervisory or enforcement authority); BM Letter at 30-31 (criticizing Cross-Border Proposing Release for including "only passing reference to foreign supervision and enforcement as discretionary factors the SEC may consider in making a substituted compliance determination," and stating that any substituted compliance determinations be predicated on evaluation of "a host of factors regarding the foreign regulatory system, including staff expertise, agency funding, agency independence, technological capacity, supervision in fact, and enforcement in fact").

At this time, however, we believe that it is appropriate to adopt a final rule to address the procedures for submitting substituted compliance requests. Using the same general procedural requirements would facilitate the efficient consideration of substituted compliance requests. Proposed Exchange Act rule 0-13, moreover, is sufficiently flexible to accommodate requests related to a range of regulatory requirements, even when the requirements necessitate different approaches toward substituted compliance.

Accordingly, we are adopting Exchange Act rule 0-13 largely as proposed. In response to commenter input, however, the final rule has been modified from the proposal to provide that a request for a substituted compliance order may be submitted either by a party that potentially would comply with requirements under the Exchange Act pursuant to a substituted compliance order, or by a relevant foreign financial regulatory authority or authorities.[737] We are persuaded that allowing foreign regulators to submit such requests would promote the completeness of requests and promote efficiency in the process for considering such requests, in light of foreign regulators' expertise regarding their domestic regulatory system, including the effectiveness of their compliance and enforcement mechanisms, and to allow for a single point of contact to facilitate the consideration of substituted compliance requests associated with the jurisdiction. We are not, however, foreclosing the ability of a market participant itself to submit a request that it be able to comply with Exchange Act requirements pursuant to a substituted compliance order.[738]

[737] The decision to permit foreign regulators to submit substituted compliance requests may impact our future consideration of proposed rule 3a71-5(c), which specified that applications for substituted compliance determinations in connection with security-based swap dealer requirements may be made by foreign dealers or by groups of foreign dealers.

[738] To the extent we receive multiple requests in connection with a particular jurisdiction, we may consider such requests together.

The final rule further revises the proposal to provide that applications should include supporting documentation regarding the methods that foreign financial regulatory authorities use to enforce compliance with the applicable rules.[739] This type of information – which we expect would be best provided by the relevant foreign regulator – is consistent with the fact that our substituted compliance assessments will not be limited to a comparison of applicable rules and their underlying goals, but also will take into account the capability of a foreign financial regulatory authority to monitor compliance with its rules and take appropriate enforcement action in response to violations of such rules.[740]

Finally, the final rule revises the proposal by removing a provision that would have stated that requestors may seek confidential treatment of their application to the extent provided by

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[739] See Exchange Act rule 0-13(e). The final rule addresses the need for applications to provide information regarding how foreign regulatory authorities "monitor and enforce" compliance with the applicable rules. The relevant language of the proposal simply referred to "monitor."

In addition, the final rule revises the proposed language regarding the Commission's ability to request applications to be withdrawn, by omitting the proposed reference to the Commission acting "through its staff." See Exchange Act rule 0-13(a).

The final rule further revises the proposed language regarding the process for considering applications, by providing that an appropriate response will be issued following "a vote by" the Commission. See Exchange Act rule 0-13(g).

[740] We note that assessments of analogous factors occur in other contexts. For example, assessments conducted by the Federal Reserve in connection with applications by foreign banks to establish a branch, agency or commercial lending company in the United States consider – and the Federal Reserve requires applications to provide information regarding – the following factors regarding the role played by the foreign bank's home country supervisor: (a) the scope and frequency of on-site examinations by the home-country supervisor; (b) off-site monitoring by the home-country supervisor; (c) the role of external auditors; (d) regulation and monitoring of affiliate transactions; (e) other applicable prudential requirements (including capital adequacy, asset classification and provisioning, single or aggregate credit and foreign currency exposure limits, and liquidity) and associated supervisor monitoring; (f) remedial authority of the home-country supervisor to enforce compliance with prudential controls and other supervisory or regulatory requirements; and (g) prior approval requirements (related to investments in other companies or the establishment of overseas offices). See Federal Reserve Board, "International Applications and Prior Notifications under Subpart B of Regulation K," (http://www.federalreserve.gov/reportforms/forms/FR_K-220110331_f.pdf). In noting this analogous requirement, we are not predicting the extent to which such factors may or may not be considered as part of the Commission's substituted compliance assessments.

Exchange Act rule 200.81. This change reflects the fact that under the final rules substituted compliance applications may be submitted by foreign financial regulatory authorities, and recognizes the importance of having the assessment consider potentially sensitive information regarding a foreign regime's compliance and enforcement capabilities and practices. Accordingly, requests for confidential treatment may be submitted pursuant to any applicable provisions governing confidentiality under the Exchange Act.[741] We expect confidential treatment requests will seek protection for privileged information obtained from foreign regulators.[742] Recognizing the significance of commenter concerns regarding the need for public comment, debate and analysis of substituted compliance requests, moreover, rule 0-13 provides that the Commission shall provide public notice of requests and solicit public comment when a

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741 For example, Exchange Act rule 24b-2 addresses the potential availability of confidential treatment in connection with any registration statement, report, application, correspondence or other document filed pursuant to the Exchange Act. The rule provides that the person filing the information must make written objection to its public disclosure at the time of the filing. See 17 CFR 240.24b-2.

Separately, Commission Rule 200.83 is a procedural rule that addresses how persons submitting information to the Commission may request that the information not be disclosed pursuant to a request under the Freedom of Information Act for reasons permitted by Federal law. The rule does not apply when any other statute or Commission rule provides procedures for confidential treatment regarding particular categories of information, or where the Commission has specified that an alternative procedure be utilized in connection with a particular study, report, investigation or other matter. Under this rule, a person submitting information to the Commission must request confidential treatment at the time of the submission. See 17 CFR 200.83.

742 Exchange Act Section 24(d) provides that the Commission generally shall not be compelled to disclose records obtained from a foreign securities authority if: (1) the foreign authority in good faith determines and represents that public disclosure of the records would violate the laws applicable to that foreign securities authority; and (2) the Commission obtains the records pursuant to procedures authorized for use in connection with the administration or enforcement of the securities laws, or a memorandum of understanding.

Exchange Act Section 24(f)(2) further provides that the Commission shall not be compelled to disclose privileged information obtain from any foreign securities authority or law enforcement authority if the foreign authority in good faith has determined and represented that the information is privileged.

complete application has been submitted.[743] We recognize that public comment regarding substituted compliance requests may be helpful to our consideration of particular requests.[744]

In adopting rule 0-13, we recognize that the requirement that an application "include any supporting documents necessary to make the application complete" implicates commenter concerns regarding the need for further guidance regarding what information must be submitted as part of substituted compliance requests. We expect to address such issues regarding supporting documentation in the future, as we consider the potential availability of substituted compliance in connection with particular Title VII requirements.

C. Economic Analysis

The availability of substituted compliance has the potential to impact the interplay between programmatic costs and benefits associated with the Title VII regulation of security-based swap dealers and major security-based swap participants, as well as those associated with other Title VII requirements. For example, substituted compliance potentially may permit the risk management and other programmatic benefits of dealer regulation to be achieved while avoiding costs that market participants otherwise may incur. At the same time, the process of making substituted compliance requests may cause certain market participants to incur extra costs, although that possibility may be obviated in part by the provision that permits foreign financial authorities to make such requests.

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[743] The text of the final rule has been revised from the proposal to eliminate a reference to the Commission having "sole discretion" to choose to publish a notice, and to provide that publication would occur following submission of a "complete" application. See Exchange Act rule 0-13(h).

[744] The final rule also makes technical change to the proposal by replacing references to the Commission's Division of Trading and Markets with general references to the "staff," consistent with the broad range of issues that will likely arise in connection with evaluating substituted compliance requests. See Exchange Act rule 0-13(a), (g).

As discussed throughout this release, the security-based swap market is a global market that is subject to regulatory requirements that may vary by jurisdiction. As a result, market participants that operate globally potentially could be subject to overlapping or conflicting regulations. If Title VII requirements for non-U.S. market participants conflict with regulations in local jurisdictions, Title VII could act as a barrier to entry to the U.S. security-based swap market. In such cases, allowing market participants to comply with Title VII via substituted compliance could act as a mechanism to preserve access for non-U.S. persons to the U.S. security-based swap market, reducing the likelihood that non-U.S. persons exit the U.S. market entirely. Therefore, we expect that substituted compliance – so long as it is conditioned on a foreign regime's comparability to the relevant requirements under the Dodd-Frank Act, and on the foreign regime having adequate compliance and enforcement capabilities – would help preserve access and competition in the U.S. market, and thus benefit non-dealer participants in the security-based swap market.[745]

Although the costs associated with the process of making substituted compliance request may be uncertain at this time, the decision to request substituted compliance is purely voluntary. To the extent such requests are made by market participants, moreover, such participants would request substituted compliance only if, in their own assessment, compliance with applicable requirements under a foreign regulatory system was less costly than compliance with both the foreign regulatory regime and the relevant Title VII requirement. Even after a substituted compliance determination is made, market participants would only choose substituted compliance if the private benefits they expect to receive from participating in the U.S. market exceeds the private costs they expect to bear, including any conditions the Commission may

[745] Cf. Institute of International Finance ("IIF") Letter (making a similar point).

attach to the substituted compliance determination. Where substituted compliance increases the number of dealers or other participants in the U.S. security-based swap market, or prevents existing participants from leaving the U.S. market, this may help mitigate the programmatic costs associated with the applicable Title VII requirements, while helping to ensure that the associated programmatic benefits are achieved.

The costs particularly associated with making substituted compliance requests, as well as the general costs and benefits associated with allowing substituted compliance, may be expected to vary between the various categories of Title VII requirements. Relevant considerations may include: whether (and to what extent) substituted compliance is permitted in connection with a requirement; the relevant information required to demonstrate consistency between the foreign regulatory requirements and the Commission's analogous dealer requirements; the relevant information required to demonstrate the adequacy of the foreign regime's compliance and enforcement mechanisms; and whether substituted compliance requests are made by market participants or by foreign regulatory authorities. These factors limit our ability to further predict the economic consequences of this procedural rule.

We recognize that commenters have asked that the Commission coordinate with the CFTC and foreign regulators in making substituted compliance determinations. As discussed above, the Commission is subject to obligations to consult and coordinate with the CFTC and foreign regulators in connection with Title VII.[746] Our revision of the final rule to permit foreign regulators to submit substituted compliance requests also helps address goals of increased coordination. Moreover, our substituted compliance assessments regarding particular requirements applicable to security-based swap dealers also as appropriate may take into account

[746] See section II.B, supra.

the way that other regulators address similar issues, subject to the need for any allowance of substituted compliance to be predicated on the extent to which compliance with another regulatory regime will help achieve the goals of Title VII.

VII. Antifraud Authority

A. Final Rule

The provisions of the rules and guidance, discussed above, do not limit the cross-border reach of the antifraud provisions or other provisions of the federal securities laws that are not specifically addressed by this release.

In section 929P(b) of the Dodd-Frank Act, Congress added provisions to the federal securities laws confirming the Commission's broad cross-border antifraud authority.[747] Congress enacted section 929P(b) in the wake of the Supreme Court's decision in Morrison v. National Australia Bank,[748] which created uncertainty about the Commission's cross-border enforcement authority under the antifraud provisions of the federal securities laws. Before Morrison, the federal courts of appeals for nearly four decades had construed the antifraud provisions to reach cross-border securities frauds when the fraud either involved significant conduct within the United States causing injury to overseas investors, or had substantial foreseeable effects on investors or markets within the United States.[749] With respect to the Commission's enforcement authority, section 929P(b) codified the courts of appeals' prior

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747 The antifraud provisions of the securities laws include section 17(a) of the Securities Act, 15 U.S.C. 77q(a); sections 9, 10(b), 14(e), and 15(c)(1)-(2) & (7) of the Exchange Act, 15 U.S.C. 78i, 78j, 78n, 78o(c)(1)-(2); section 206 of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6; and any rule or regulation of the Commission promulgated under these statutory authorities.

748 See 130 S. Ct. 2869, 2888 (2010) (holding in a section 10(b) class action that "it is ... only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which §10(b) applies").

749 See, e.g., Schoenbaum v. Firstbrook, 405 F.2d 200, 206 (2d Cir. 1968), modified on other grounds, 405 F.2d 215 (1968) (en banc).

interpretation of the scope of the antifraud provisions' cross-border reach. Section 929P(b) also made clear that the scope of subject-matter jurisdiction was coextensive with the cross-border reach of the antifraud provisions.[750]

Specifically, the Commission's antifraud enforcement authority under section 17(a) of the Securities Act and the antifraud provisions of the Exchange Act—including sections 9(j) and 10(b)—extends to "(1) conduct within the United States that constitutes significant steps in furtherance of [the antifraud violation], even if the securities transaction occurs outside the United States and involves only foreign investors," and "(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States."[751] Similarly, the Commission's enforcement authority under section 206 of the Investment Advisers Act applies broadly to reach "(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the violation is committed by a foreign adviser and involves

[750] See 156 Cong. Rec. H5237 (daily ed. June 30, 2010) (statement of Rep. Kanjorski, author of section 929P(b)) ("In the case of Morrison v. National Australia Bank, the Supreme Court last week held that section 10(b) of the Exchange Act applies only to transactions in securities listed on United States exchanges and transactions in other securities that occur in the United States. In this case, the Court also said that it was applying a presumption against extraterritoriality. This bill's provisions concerning extraterritoriality, however, are intended to rebut that presumption by clearly indicating that Congress intends extraterritorial application in cases brought by the SEC or the Justice Department. Thus, the purpose of the language of section 929P(b) of the bill is to make clear that in actions and proceedings brought by the SEC or the Justice Department, the specified provisions of the Securities Act, the Exchange Act and the Investment Advisers Act may have extraterritorial application, and that extraterritorial application is appropriate, irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States, when the conduct within the United States is significant or when conduct outside the United States has a foreseeable substantial effect within the United States."). See also 156 Cong. Rec. S5915-16 (daily ed. July 15, 2010) (statement of Senator Reed).

[751] Section 22 of the Securities Act, 15 U.S.C. 77v(a); section 27 of the Exchange Act, 15 U.S.C. 78aa.

only foreign investors," and "(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States."[752]

Although no commenters challenged the Commission's interpretation of its cross-border antifraud authority, we are aware that a federal district court recently expressed the view that the statutory language may be unclear.[753] We therefore have determined to adopt a rule that clearly sets forth our interpretation of the Commission's cross-border antifraud authority.[754] We believe that our interpretation is not only the better reading of the antifraud authorities and the statutory text added by section 929P(b), but that our reading is consistent with section 929P(b)'s legislative history and purpose.[755]

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752 Section 214 of the Investment Advisers Act, 15 U.S.C. 80b-14.

753 See SEC v. A Chicago Convention Center, LLC, 961 F. Supp. 2d 905 (N.D. Ill. 2013); see also Richard W. Painter et al., "When Courts and Congress Don't Say What They Mean: Initial Reactions to Morrison v. National Australia Bank and to the Extraterritorial Jurisdiction Provisions of the Dodd-Frank Act," 20 MINN. J. OF INTER. L. 1 (Winter 2011). But see Liu v. Siemens A.G., 2013 WL 5692504, *3 (S.D.N.Y. Oct. 21, 2013) ("Section 929P(b) permits the SEC to bring enforcement actions for certain conduct or transactions outside the United States."); SEC v. Tourre, 2013 WL 2407172, *1 n.4 (S.D.N.Y. June 4, 2013) (929P(b) "effectively reversed Morrison in the context of SEC enforcement actions"); In re Optimal U.S. Litig., 865 F. Supp. 2d 451, 456 n.28 (S.D.N.Y. 2012) ("Congress has . . . restor[ed] the conducts and effects test for SEC enforcement actions."); SEC v. Gruss, 2012 WL 3306166, *3 (S.D.N.Y. Aug. 13, 2012) ("Section 929P(b) . . . allows the SEC to commence civil actions extraterritorially in certain cases."); SEC v. Compania Internacional Financiera S.A., 2011 WL 3251813, *6 n.2 (S.D.N.Y. July 29, 2011) ("It may be that [929P(b)] was specifically designed to reinstate the Second Circuit's 'conduct and effects' test."); Cornwell v. Credit Suisse Grp., 729 F. Supp. 2d 620, 627 n.3 (S.D.N.Y. 2010) ("[I]n legislation recently enacted, Congress explicitly granted federal courts extraterritorial jurisdiction under the conduct or effect test for proceedings brought by the SEC.").

754 See rule 250.1.

755 The Morrison decision does not preclude the Commission's interpretation. When the Supreme Court construed section 10(b) in Morrison to determine its territorial scope, it acknowledged that the language of section 10(b) neither required nor precluded extraterritorial application. Morrison, 130 S.Ct. at 2881-82. It was merely silent. The Court also looked to other provisions of the Exchange Act for evidence of extraterritorial intent, but found none. The Court thus applied a default "presumption" against extraterritoriality to find that section 10(b) lacked extraterritorial effect, while making clear that this presumption was not "a limit upon Congress's power to legislate" and only applied "unless a contrary intent appears." Id. at 2877. Section 929P(b) now provides that contrary intent—in the words of Morrison, it supplies the "indication

Further, we believe that our interpretation of the cross-border antifraud enforcement authority best advances the strong interest of the United States in applying the antifraud provisions to cross-border frauds that implicate U.S. territory, U.S. markets, U.S. investors, other U.S. market participants, or other U.S. interests.[756] We believe that our interpretation of the cross-border antifraud authority is necessary to ensure honest securities markets and high ethical standards in the U.S. securities industry, and thereby to promote confidence in our securities markets among both domestic and foreign investors. Our interpretation of the cross-border antifraud authority will also allow us to better protect U.S. investors from securities frauds executed outside of the United States where those frauds may involve non-domestic securities transactions but nonetheless threaten to produce, foreseeably do produce, or were otherwise intended to produce effects upon U.S. markets, U.S. investors, other U.S. market participants, or other U.S. interests.

B. Economic Analysis

This rule is designed to ensure the antifraud provisions of the securities laws are provided broad cross-border reach. Effective cross-border enforcement of the antifraud provisions should help detect and deter or stop transnational securities frauds the final rule may mitigate inefficiencies in allocation of capital. For example, by directly diverting financial resources from more productive projects to less productive projects, serious transnational securities frauds can generate welfare losses.

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of an extraterritorial application" that had been missing. Our interpretation is thus, at a minimum, a reasonable reading of the antifraud provisions in light of section 929P(b)'s enactment.

756 See generally RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 402 (1987) (stating that "the United States has authority to prescribe law with respect to … conduct that, wholly or in substantial part, takes place within its territory; the status of persons, or interests in things, present within its territory" and "conduct outside its territory that has or is intended to have substantial effect within its territory").

Further, in the absence of the cross-border application of the antifraud provisions, the perceived risk of fraud may indirectly result in less efficient capital allocation if it reduces investors' trust in the securities market.[757] Additionally, given the global nature of the securities market, ensuring that antifraud provisions of the securities laws have cross-border reach will reduce the likelihood of a fragmented market. As a result of reduced ambiguity over the degree to which they are protected from fraud, U.S. market participants will have fewer incentives to avoid cross-border activity because, as explained above, they will have increased confidence in the integrity of the market. Through this channel, the final rules support a market that provides greater opportunities for U.S. market participants to share risks with market participants in other jurisdictions.

VIII. Impacts on Efficiency, Competition, and Capital Formation

In developing our approach to the cross-border application of the Title VII security-based swap dealer and major participant definitions, we have focused on meeting the goals of Title VII, including the promotion of the financial stability of the United States, by the improvement of accountability and transparency in the U.S. financial system and the protection of counterparties to security-based swaps. We also have considered the effects of our policy choices on competition, efficiency, and capital formation as mandated under section 3(f) of the Exchange Act. That section requires us, whenever we engage in rulemaking pursuant to the Exchange Act and are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will

757 See e.g., Luigi Guiso, Paola Sapienza, and Luigi Zingales. "Trusting the stock market," 63 J. Fin. Vol. 63, No. 6: 2557 2600 (2008); see also David Easley and Maureen O'Hara, Microstructure and Ambiguity, 65 J. Fin. 1817 (2010).

promote efficiency, competition, and capital formation.[758] In addition, section 23(a)(2) of the Exchange Act requires us, when making rules under the Exchange Act, to consider the impact such rules would have on competition. Section 23(a)(2) also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[759]

In this section, we focus particularly on these effects. In adopting these final rules, we recognize that the most significant impact of the cross-border implementation of the dealer and major participant definitions will derive from the role of the definitions in determining which market entities are subject to security-based swap dealer and major security-based swap participant regulation under Title VII and which entities are not. That is, the scope of the final definitions will affect the ultimate regulatory costs and benefits that will accompany the full implementation of Title VII rules aimed at increasing transparency, accountability, and financial stability. Furthermore, the final cross-border rules may create incentives for market participants, including dealers as well as non-dealers and other non-registered entities who transact with dealers, to structure their businesses to operate wholly outside of the Title VII framework. This incentive may be particularly strong for entities at the boundaries of the definitions – for example, entities with relatively limited contact with U.S. persons – for whom the benefits of operating outside of Title VII may exceed the costs of restructuring or forgoing trading opportunities with U.S. counterparties.

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758 15 U.S.C. 78c(f).

759 15 U.S.C. 78w(a)(2).

A. Competition

As noted above, a key goal of Title VII of the Dodd-Frank Act is to promote the financial stability of the United States by improving accountability and transparency in the financial system. To that end, Title VII imposes new regulatory requirements on market participants who register as security-based swap dealers or major participants. The final cross-border implementation of the dealer and major participant definitions discussed in this release, including the cross-border implementation of the de minimis exception, will likely affect competition in the U.S. security-based swap market and potentially change the set of available counterparties that would compete for business and provide liquidity to U.S. market participants. Though these substantive Title VII requirements have not been finalized, application of Title VII to registered dealers and major participants may directly affect the competitive landscape of the security-based swap market.

As detailed above, the security-based swap market is a global, interconnected market. Within this global market, foreign and domestic dealers compete for business from counterparties, while non-dealers (including major participants) that participate in the market use security-based swaps for purposes that can include speculation and hedging. Because the market for security-based swaps is a global market and some participants may not engage in relevant security-based swap activity within the United States, the rules we adopt pursuant to Title VII will not reach all participants or all transactions in the global market. We are aware that application of rules to a subset of participants in the worldwide security-based swap market would change the costs and benefits of market participation for one group (those that engage in relevant security-based swap activity within the United States) relative to another (those that do not) and therefore create competitive effects.

More specifically, in addition to requiring U.S. dealers to register, our final rules implementing the cross-border approach to the security-based swap dealer definition would generally apply dealer registration and other Title VII requirements to non-U.S. entities that conduct dealing activity (as defined in the Intermediary Definitions Adopting Release) in excess of the de minimis threshold, but where calculation of the threshold depends on various features of the person's transactions (e.g., whether the person's counterparty is a U.S. or non-U.S. person, whether the transaction is guaranteed by a U.S. person, whether the counterparty is a registered or non-registered foreign branch of a U.S. person, and whether the person is a conduit affiliate of a U.S. person). Similarly, our final rules implementing cross-border application of the major security-based swap participant definition would apply major participant registration and other Title VII requirements to entities that have exposures to U.S. persons that exceed the major participant thresholds (as defined in the Intermediary Definitions Adopting Release). Given the approach we are adopting with respect to application of the dealer de minimis and major participant threshold calculation requirements, U.S. persons should have no incentive to favor a non-U.S. person counterparty over a U.S.-person counterparty.

However, we recognize that the final rule treats U.S. persons and different types of non-U.S. persons differently. Unless their dealing activity is guaranteed by a U.S. person, non-U.S. persons may exclude from their de minimis calculations dealing activity with other non-U.S. persons. Similarly, unless their security-based swap activity is guaranteed by a U.S. person, non-U.S. persons may exclude from their major participant threshold calculations their positions with non-U.S. persons. U.S. persons, non-U.S. persons whose security-based swap transactions are guaranteed by a U.S. person, and conduit affiliates cannot exclude such transactions or positions from their own calculations. This differential treatment makes it more likely that non-U.S.

persons will not be subject to the regulatory requirements associated with dealer and major participant registration. Furthermore, because transactions with U.S. persons in excess of the de minimis and major participant thresholds trigger registration requirements, non-U.S. dealers and other market participants may be reluctant to trade with U.S. counterparties or clear security-based swap transactions through U.S. person clearing agencies because of the potential application of Title VII regulation. For example, our final rules may produce competitive frictions insofar as market participants prefer to clear transactions using non-U.S. person clearing agencies who may have U.S. person members instead of U.S. person clearing agencies, because only positions held against the latter would count against their major participant thresholds.[760] Indeed, some entities may determine that the compliance costs arising from the requirements of Title VII warrant exiting the security-based swap market in the United States entirely. Non-U.S. persons may find this option more attractive than U.S. persons because they may find it easier to structure their foreign business so as to prevent it from falling within the scope of Title VII. However, U.S. entities may also have an incentive to establish separately-capitalized foreign subsidiaries to conduct their security-based swap operations, since such subsidiaries would qualify as non-U.S. persons.[761] In this case, the cross-border application of Title VII rules may affect participants depending on their size, as larger participants could be better-equipped to set up offshore vehicles enabling them to transact as non-U.S. persons.

To the extent that entities engaged in dealing activity exit the U.S. security-based swap market, the end result could be a U.S. market where fewer intermediaries compete less

760 See section V.D.1(b).

761 The rules we are adopting regarding conduit affiliates should mitigate this risk to some degree, as the foreign affiliate's non-U.S. person counterparties would not generally be able to engage in security-based swap dealing activity on behalf of its U.S.-person affiliate without itself being required to include those transactions in its own de minimis calculations.

intensively for business. These exits could result in higher spreads and reduced liquidity, and could affect the ability and willingness of non-dealers within the United States to engage in security-based swaps. The concentrated nature of dealing activity suggests that there are high barriers to entry in connection with security-based swap dealing activity, which could preclude the ability of new dealers to enter the security-based swap market and compete away spreads.

Notwithstanding the potential that our final rule may reduce competition, the Commission believes it appropriate to require U.S. persons to count all dealing transactions towards the de minimis threshold and all positions toward the major security-based swap participant thresholds, given the potential for these transactions to create risk to U.S. persons and in the U.S. financial system. We also note that it is uncertain that such requirements will reduce competition. In fact, the final rule may enhance competition among dealers, as the Title VII regulatory requirements and the ability to meet the standards set by Title VII may allow registered dealers to credibly signal high quality, better risk management, and better counterparty protection relative to foreign unregistered dealers that compete for the same order flow. In this scenario, non-dealers in the U.S. market may be willing to pay higher prices for higher-quality services in regulated markets, and registration requirements may separate high-quality intermediaries that are willing and able to register from low-quality firms that are not.[762]

[762] Cf. Carl Shapiro, "Investment, Moral Hazard, and Occupational Licensing," The Review of Economic Studies, Vol. 53, No. 5 (1986) (using a theoretical model to show "that licensing and certification tend to benefit customers who value quality highly at the expense of those who do not"). Oren Fuerst, "A Theoretical Analysis of the Investor Protection Regulations Argument for Global Listing of Stocks," Working Paper (1998) (using a theoretical model of the listing decision to show how managers of high quality firms signal their quality more effectively in a strict regulatory regime). Craig Doidge, G. Andrew Karolyi, and Rene M. Stulz, "Why are Foreign Firms Listed in the U.S. Worth More?" Journal of Financial Economics, Vol. 71, Issue 2 (2004) (hypothesizing that firms cross-listed in the United States are better able to take advantage of growth opportunities, and finding that "expected sales growth is valued more highly for firms listing in the U.S. and that this effect is greater for firms from countries with poorer investor

Furthermore, while dealers and speculative traders may prefer to transact in opaque markets, transparency requirements that apply to U.S. dealers and transactions that occur within the scope of Title VII may be attractive to hedgers and other market participants who do not benefit from opacity. Therefore, Title VII requirements may promote liquidity in the U.S.; liquid markets should attract additional participants, thereby enhancing risk sharing and making markets more competitive. These regulatory benefits could mitigate the competitive burdens imposed by the proposed and anticipated final cross-border rules and substantive Title VII requirements applicable to registered security-based swap dealers by, for example, reducing incentives for firms to exit the market.

Similarly, the cross-border application of the de minimis exception could reduce the number of entities likely to exit the U.S. market entirely because it would enable an established foreign entity to transact a de minimis amount of security-based swap dealing activity in the U.S. market before it determines whether to expand its U.S. business and become a registered security-based swap dealer.[763] However, since the ability of smaller entities to access the U.S. security-based swap market without registration would be limited to conducting dealing activity below the de minimis threshold, these entities would have an incentive to curtail their security-based swap dealing activity with U.S. persons as they approach the de minimis threshold to avoid dealer registration requirements.

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rights"). While economic theory supports the assertion that registration can separate high-quality dealers from low-quality dealers, with corresponding differences in pricing, we received no comments either agreeing or disagreeing with the assertion that some market participants may be willing to pay higher prices to trade with a high-quality intermediary.

763 See IIF Letter (noting that, "...the rule proposal if adopted would make it much easier for foreign market participants to offer services in the US, providing greater choice and competition, and making it easier for instance for corporates to hedge their risks)."

Finally, incentives to restructure ultimately depend on future regulatory developments, both with respect to final Title VII rules and foreign regulatory frameworks; the differences in regulatory requirements across jurisdictions; and strategic interactions with non-dealer participants. For example, although pre-and post-trade transparency requirements provide a number of benefits both to financial markets and the real economy, dealers benefit from operating in opaque markets. To the extent that foreign jurisdictions require only regulatory reporting, without public dissemination requirements, dealers may wish to operate in jurisdictions where they can continue to benefit from opaque markets.

Other market participants, however, may prefer transparency, and the availability of transparent trading venues that result from Title VII pre- and post-trade transparency requirements could shift market power away from dealers. If non-dealer market participants are able to demand transparent trade execution, the incentives to restructure may be tempered, particularly if transparent venues attract liquidity away from opaque markets. Ultimately, the effects of transparency requirements on dealers' incentives to restructure depend on differences across jurisdictions, as well as whether non-dealer participants prefer transparency. These preferences may, in turn, depend on motives for trading among non-dealers. Hedgers and participants that need liquidity may prefer transparent venues while participants who believe they have private information about asset values may prefer opaque markets that allow them to trade more profitably on their information.

The potential restructurings and exits described above may impact competition in the U.S. market in different ways. On one hand, the ability to restructure one's business rather than exit the U.S. market entirely to avoid application of Title VII to a person's non-U.S. operations may reduce the number of entities that exit the market, thus mitigating the negative effects on

competition described above. On the other hand, U.S. non-dealers may find that the only foreign security-based swap dealers that are willing to deal with them are those whose security-based swap business is sufficiently large to afford the costs of restructuring as well as registration and the ensuing compliance costs associated with applicable Title VII requirements. To the extent that smaller dealers continue to have an incentive to exit the market, the overall level of competition in the market may decline.

Moreover, regardless of the response of dealers to our approach, we cannot preclude the possibility that large non-dealer financial entities and other non-dealer market participants in the United States, such as investment funds, who have the resources to restructure their business also may pursue restructuring and move part of their business offshore in order to transact with dealers outside the reach of Title VII, either because liquidity has moved offshore or because these participants want to avoid Title VII requirements (such as transparency requirements) that may reveal information about trading strategies. This may reduce liquidity within the U.S. market and provide additional incentives for U.S. persons and non-U.S. persons to shift a higher proportion of their security-based swap business offshore, further reducing the level of competition within the United States. In this scenario, the competitive frictions caused by the application, in the cross-border context, of a de minimis threshold for dealing activity may affect the ability of small market participants of security-based swaps to access the security-based swap market more than large ones, as smaller participants are less likely to have the resources that would enable or justify a restructuring of their business.

In addition to the global nature of the security-based swap market and the implications for the reach of Title VII dealer and major participant registration requirements, we also noted above the current opacity of the over-the-counter derivatives market and the informational

advantage that dealers currently have over non-dealers. By having greater private order flow information, dealers are in a position to make more-informed assessments of market values and can use that information to extract rents from less-informed counterparties. While this issue will be the focus of future Commission rulemaking covering pre- and post-trade transparency, we note that the final rule to exclude cleared, anonymous transactions from the de minimis threshold for non-U.S. persons has implications for competition in the security-based swap market. Because cleared, anonymous transactions will not trigger registration requirements, the exclusion strengthens incentives for trading in transparent venues, reducing market power and the competitive advantage currently enjoyed by dealers over non-dealer market participants. Furthermore, while Title VII rules governing clearing, trade execution, and trade reporting have not been finalized, providing stronger incentives to trade on transparent venues and through CCPs increases the likelihood that the benefits of Title VII, including increased transparency and reduced potential for risk spillovers, will be realized.[764]

The overall effects of the final approach described in this release on competition among dealing entities in the U.S. security-based swap market will depend on the way market participants ultimately respond to different elements of Title VII. Application of the dealer and major participant registration requirements may create incentives for dealers and market participants to favor non-U.S. counterparties; incentives to restructure due to inconsistent regulatory requirements may increase concentration among security-based swap dealers providing services to U.S. non-dealers. However, registration and compliance with Title VII

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[764] The exclusion for cleared, anonymous transactions does not require participants to use a registered clearing agency. Therefore, this benefit may be limited if final Title VII rules for registered clearing agencies create incentives for market participants to trade through CCPs that are not registered and regulated under Title VII.

may signal high quality and mitigate the incentive to restructure and exit U.S. markets for intermediaries with the ability to meet the standards set by Title VII. Furthermore, if hedgers and other market participants who do not benefit from opacity demand transparency and counterparty protections that come from trading with a registered dealer, dealers may prefer to register if serving this market is profitable. Finally, while fewer dealing entities could lead to decreased competition and wider spreads in the security-based swap market, exclusion of cleared, anonymous trades from the de minimis threshold strengthen incentives to trade in transparent venues, reducing the ability of dealing entities to post wider spreads and reducing the competitive advantage over access to information enjoyed by dealers.

B. Efficiency

As noted above, in adopting the rules and guidance discussed in this release, we are required to consider whether these actions would promote efficiency. In significant part, the effect of these rules on efficiency is linked to the effect of these rules on competition. Definitional rules that promote, or do not unduly restrict, competition can be accompanied by regulatory benefits that minimize the risk of liquidity crises, aggregate capital shortfalls, and other manifestations of contagion. Furthermore, by reducing the costs that individual market participants impose on others through their trades – that is, by imposing registration requirements and substantive regulations on dealers and major participants who, by virtue of the volume of their transactions, their number of counterparties, and their aggregate positions and exposures, are most likely to contribute to risk spillovers – the rules promote efficiency within the market. Generally, rules and interpretations that promote competitive capital markets can be expected to promote the efficient allocation of risk, capital, and other resources by facilitating price

discovery and reducing costs associated with dislocations in the market for security-based swaps.[765]

As discussed several times throughout this release, the global nature of the security-based swap market suggests that the regulatory framework adopted under Title VII may not reach all participants or all transactions. Additionally, differing regulatory timelines and differences in regulatory scope may moderate the benefits flowing from Title VII. In particular, if other regulatory regimes offer more opacity in transactions, those who are most harmed by transparency (including dealers who currently benefit from privately observing order flow) have incentives to restructure their business to operate abroad or otherwise take advantage of regulatory gaps. Restructuring itself, while potentially optimal for an individual participant, represents a form of inefficiency for the overall market in that firms expend resources simply to circumvent regulation and not for any productive purpose.

More importantly, altering business models to take advantage of looser regulatory regimes undermines other efficiency benefits to Title VII. For example, U.S. dealers may have an incentive to restructure their businesses by setting up separately capitalized entities in non-U.S. jurisdictions, through which they would continue their dealing operations in order to take advantage of the rules applicable to non-U.S. persons. As discussed above, if some market participants choose to operate wholly outside of the Title VII regulatory framework, risk and liquidity may concentrate in less regulated, opaque corners of the market, undermining the benefits of Title VII. Moreover, insofar as the types of restructuring contemplated above purely constitute attempts at arbitraging regulations, including regulations applied to registered dealers,

[765] Definitional rules do not promote efficiency by themselves; rather, the effect is through the number of entities required to register as dealers and major participants, and the corresponding effect on the programmatic costs and benefits associated with registration requirements.

such as capital and reporting regulations, they represent a use of resources that could potentially be put to more productive uses. Ultimately, the incentive to restructure, and the corresponding loss of benefits, depends on the extent to which other jurisdictions implement comprehensive OTC derivatives regulations. If foreign jurisdictions subject security-based swap transactions to regulatory oversight consistent with Title VII, the ability to arbitrage regulations will be limited.[766]

Nevertheless, two features of our rules adopted today may mitigate the incentive for market participants to undermine the benefits of Title VII through inefficient restructuring or evasion. First, the requirement that conduit affiliates count all dealing activity towards the de minimis threshold closes one potential path for evasion. We have tailored the application of these requirements in connection with affiliates of registered security-based swap dealers and major security-based swap participants, as we do not believe that transactions involving these types of registered entities and their foreign affiliates raise the types of evasion concerns that the conduit affiliate concept is designed to address.[767] Second, the exclusion of cleared, anonymous transactions from the de minimis threshold for non-U.S. persons strengthens incentives for trading in transparent venues, reducing the incentive to trade in opaque corners of the market in order to avoid the reach of Title VII. Strengthening incentives for non-U.S. persons to trade in transparent venues reduces the likelihood that liquidity will fragment to opaque corners of the market and increases the likelihood that risks that non-U.S. persons present to the U.S. financial system will be covered by the Title VII regulatory framework. Furthermore, shifting trades to

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766 See Section III.B, supra (discussing global regulatory efforts).

767 See note 320, supra.

transparent venues produces benefits associated with pre- and post-trade price transparency, including more efficient valuations of financial assets.[768]

Finally, we received several comments from outside commenters urging us to harmonize our final rules with interpretations set forth in the CFTC's guidance.[769] While our final rules track the CFTC's guidance in many respects – for example, in the treatment of conduit affiliates, the treatment of transactions with foreign branches, and the exclusion for cleared, anonymous transactions from non-U.S. persons' de minimis calculations – we are not adopting rules identical to the policies and interpretations in the guidance. For example, our treatment of investment funds with respect to the U.S. person definition differs from the CFTC's, which, in addition to looking to the location of incorporation and principal place of business, considers majority-ownership. While we acknowledge the benefits of harmonization, we believe our rules meet the goals of Title VII while appropriately minimizing the costs to security-based swap market participants. More specifically, our rules are designed to capture transactions and entities that pose risk to U.S. persons and potentially to the U.S. financial system, while excluding those transactions and entities that do not warrant regulation under Title VII. In the case of investment funds, we have decided not to look to majority-ownership for determining U.S.-person status, notwithstanding that the CFTC Cross-Border Guidance articulates such an approach. Our belief is that, by adopting an approach that generally focuses on the location of economic decisions made on behalf of a fund, we are more accurately measuring whether a fund poses risks to U.S.

[768] As discussed above, this benefit may be limited if final Title VII rules for registered clearing agencies create incentives for market participants to trade through CCPs that are not registered and regulated under Title VII.

[769] See note 193, supra.

persons and to the U.S. financial system of the type that Title VII was intended to address.[770] Nevertheless, we acknowledge that different regulations for swaps and security-based swaps may create inefficiencies for market participants due to conflicting or overlapping requirements, particularly for those participants who deal in both swaps and security-based swaps.

C. Capital Formation

We believe that many aspects of the final cross-border approach to the dealer and major participant definitions are likely to promote capital formation, by focusing dealer and major participant regulation on activity and entities that are most likely to serve as conduits of risk to U.S. persons and potentially to the U.S. financial system. We also believe that applying the full range of Title VII requirements to this group of entities will increase the likelihood that the benefits of Title VII, including increased transparency, accountability, and financial stability, will be realized. To the extent that these requirements reduce asymmetric information about market valuations, we expect that a security-based swap market with enhanced transparency and enhanced regulatory oversight may facilitate entry by a wide range of market participants seeking to engage in a broad range of hedging and trading activities.

Additionally, strengthening incentives for non-U.S. persons to trade in transparent venues encourages market participants to express their true valuations for security-based swaps; information revealed through transparent trades allows market participants to derive more-informed assessments with respect to asset valuations, leading to more efficient capital allocation. This should be true for the underlying assets as well. That is, information learned

[770] For instance, as discussed above, LTCM demonstrated that an investment vehicle could have a negative impact on U.S. financial institutions and on the stability of the U.S. financial system more generally when the vehicle is directed, controlled, or coordinated from within the United States. See note 271, supra.

from security-based swap trading provides signals not only about security-based swap valuation, but also about the value of the reference assets underlying the swap.[771] Similarly, we expect transparency to benefit the real economy as well. Transparent prices provide better signals about the quality of a business investment, promoting capital formation in the real economy by helping managers to make more-informed decisions and making it easier for firms to obtain new financing for new business opportunities.[772]

However, the Commission recognizes that, to the extent that the cross-border implementation of the dealer and major participant definitions encourages inefficient restructuring or results in market fragmentation, the final rules may impair capital formation and result in a redistribution of capital across jurisdictional boundaries. We note that, unlike in the proposed rules, we are requiring non-U.S. persons with U.S. guarantees to include all transactions that benefit from a U.S. guarantee in their de minimis calculations. Similarly, we are requiring conduit affiliates to include all transactions in their de minimis calculations, whether with a U.S. person or not. Inclusion of these transactions will limit the risk these participants pose to U.S. persons and to the U.S. financial system. More generally, the definition of "U.S. person" mitigates the risk of contagion affecting U.S. markets as a result of cross-border swap activity. To the extent that future substantive regulation under Title VII is conditioned on entities' registration status, this definition may also improve transparency and provide increased customer protection for U.S. persons who participate in the security-based swap market.

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771 See Sugato Chakravarty, Huseyin Gulen, and Stewart Mayhew, "Informed Trading in Stock and Option Markets," Journal of Finance, Vol. 59, No. 3 (2004) (estimating that the proportion of information about underlying stocks revealed first in option markets ranges from 10 to 20 percent).

772 See Philip Bond, Alex Edmans, and Itay Goldstein, "The Real Effects of Financial Markets," Annual Review of Financial Markets, Vol. 4 (Oct. 2012) (reviewing the theoretical literature on the feedback between financial market prices and the real economy).

Nevertheless, expanding the scope of transactions that must be included in these calculations may also increase the scope of potential market fragmentation, to the extent that it raises the costs that market participants will incur if they engage in security-based swap activity through guaranteed non-U.S. persons or conduit affiliates.

IX. Paperwork Reduction Act

A. Introduction

The Paperwork Reduction Act of 1995 ("PRA")[773] imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any "collection of information."[774] 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. In addition, 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 of information; (3) a brief description of the need for the information and the proposed 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.[775]

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773 44 U.S.C. 3501 et seq.

774 44 U.S.C. 3502(3).

775 44 U.S.C. 3507(a)(1)(D) (internal formatting omitted); see also 5 CFR 1320.5(a)(1)(iv).

In the Cross-Border Proposing Release, we identified a number of proposed rules that contained "collection of information requirements" within the meaning of the PRA.[776] The majority of those proposed rules and forms are outside of the scope of the dealer and major participant definitions at issue in this release.[777] In two areas, however, Exchange Act rule 3a71-3 which we are adopting today contains collections of information requirements. First, the rule's definition of "transaction conducted through a foreign branch," which we are adopting largely as proposed, contains a representation provision that constitutes a collection of information. Moreover, the rule's final definition of "U.S. person" incorporates, as an addition to the proposal, a representation provision that constitutes a collection of information.[778] Commenters did not address Paperwork Reduction Act issues in connection with the proposal.

The Commission previously submitted proposed rule 3a71-3, as well as certain other rules proposed as part of the Cross-Border Proposing Release, to OMB for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The title of the collection related to proposed rule

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[776] See Cross-Border Proposing Release, 77 FR at 31103.

[777] In particular, the present release does not address the following proposed rules and forms that implicated collections of information under the Paperwork Reduction Act: proposed Rule 3Ch-2; reproposed Forms SBSE, SBSE-A and SBSE-BD; proposed Rule 18a-4, and reproposed Rules 242.900 through 242.911 of Regulation SBSR. We expect to address those Paperwork Reduction Act issues in connection with our consideration of those proposed rules and forms.

In addition, the representation provision of the proposed definition of "transaction conducted within the United States" contained a collection of information. These final rules do not encompass that collection of information requirement, however, because we are not adopting the "transaction conducted within the United States" element of the proposed rule in this release. See section I.A, supra.

[778] We also note that Exchange Act rule 0-13, which we are adopting today, determines the procedures for market participants and foreign regulatory authorities to submit substituted compliance requests. The rule, however, does not provide any substituted compliance rights, and its applicability will be determined solely by the substituted compliance provisions of the substantive rulemakings. Accordingly, collection of information arising from substituted compliance requests, including associated control numbers, will be addressed in connection with any applicable substantive rulemakings that provide for substituted compliance.

3a71-3 is "Reliance on Counterparty Representations Regarding Activity Within the United States." OMB has not yet assigned Control Numbers in connection with rule 3a71-3 or the other rules submitted in connection with the proposal.

B. Reliance on Counterparty Representations Regarding Transactions Conducted Through a Foreign Branch

1. Summary of Collection of Information

When determining whether a security-based swap transaction constitutes a "transaction conducted through a foreign branch," a person may rely on its counterparty's representation that the transaction "was arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States, unless such person knows or has reason to know that the representation is not accurate."[779]

2. Proposed Use of Information

Under the final rules, a non-U.S. person need not count, against the applicable thresholds of the dealer exception and the major security-based swap participant definition, dealing transactions with foreign branches of U.S. banks that are registered as security-based swap dealers. For these purposes, the foreign branch must be the counterparty to the security-based swap transaction, and the transaction must be arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States.[780]

As discussed in the Cross-Border Proposing Release, the Commission acknowledges that verifying whether a security-based swap transaction falls within the definition of "transaction conducted through a foreign branch" could require significant due diligence. The definition's representation provision would mitigate the operational difficulties and costs that

779 See Exchange Act rule 3a71-3(a)(3)(ii).

780 See Exchange Act rule 3a71-3(a)(3)(i).

otherwise could arise in connection with investigating the activities of a counterparty to ensure compliance with the corresponding rules.[781]

These representations would be provided voluntarily by the counterparties to certain security-based swap transactions to other counterparties; therefore, the Commission would not typically receive confidential information as a result of this collection of information. However, to the extent that the Commission receives confidential information described in this representation provision through our examination and oversight program, an investigation, or some other means, such information would be kept confidential, subject to the provisions of applicable law.[782]

3. Respondents

Based on our understanding of the OTC derivatives markets, including the size of the market, the number of counterparties that are active in the market, and how market participants currently structure security-based swap transactions, the Commission estimates that up to 15 entities that are registered as security-based swap dealers may include a representation that a security-based swap is a ''transaction conducted through a foreign branch'' in their trading relationship documentation (e.g., the schedule to a master agreement).[783]

[781] See Cross-Border Proposing Release, 78 FR at 31107.

[782] 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." 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 prepare by, or on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." 5 U.S.C. 552(b)(8)).

[783] We have estimated that up to 50 entities may register with the Commission as security-based swap dealers, based on an analysis of 2012 data indicating that 27 entities had $3 billion or more in notional transactions that would be counted against the thresholds under the final rules, and further accounting for new entrants into the market. See note 444, supra, and accompanying text. Because six of those 27 entities are domiciled in the United States, we conservatively estimate that it is possible that new entrants may lead up to 15 registered dealers to be U.S. banks.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

The estimates in this section reflect the Commission's experience with burden estimates for similar requirements and discussions by our staff with market participants. The Commission believes that, in most cases, the representations associated with the definition of "transaction conducted through a foreign branch" would be made through amendments to the parties' existing trading documentation (e.g., the schedule to a master agreement).[784] Because these representations relate to new regulatory requirements, the Commission anticipates that counterparties may elect to develop and incorporate these representations in trading documentation soon after the effective date of the Commission's security-based swap regulations, rather than incorporating specific language on a transactional basis. The Commission believes that parties would be able to adopt, where appropriate, standardized language across all of their security-based swap trading relationships. This language may be

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Although not all U.S. banks engaged in security-based swap dealing activity currently operate foreign branches, we also conservatively estimate that all such dealers that are U.S. banks would do so.

In the Cross-Border Proposing Release, we preliminarily estimated that 50 entities may include a representation that a transaction constitutes a "transaction conducted through a foreign branch." See Cross-Border Proposing Release, 78 FR at 31108. This revised estimate reflects the fact that under the final rules such a representation would be relevant only if provided by a person that is registered with the Commission as a security-based swap dealer. In practice, however, based on our understanding of changes in the way major U.S. dealers engage with non-U.S. counterparties in the single-name CDS market following the issuance of the CFTC Cross-Border Guidance, we believe that few, if any, U.S. persons currently may participate in the single-name CDS market through their foreign branches. Also, as noted above, moreover, we recognize that other regulatory provisions may limit the ability of U.S. banks to conduct security-based swap activity. See note 366, supra.

[784] The Commission believes that because trading relationship documentation is established between two counterparties, the question of whether one of those counterparties, that is registered with the Commission as a security-based swap dealer, is able to represent that it is entering into a "transaction conducted through a foreign branch" would not change on a transaction-by-transaction basis and, therefore, such representations would generally be made in the schedule to a master agreement, rather than in individual confirmations.

developed by individual firms or through a combination of trade associations and industry working groups.

The Commission estimates the maximum total paperwork burden associated with developing new representations would be, for each U.S. bank registered as a security-based swap dealer that may make such representations, no more than five hours, and up to $2,000 for the services of outside professionals, for an estimate of approximately 75 hours and $30,000 across all security-based swap counterparties that may make such representations. This estimate assumes little or no reliance on standardized disclosure language.

The Commission expects that the majority of the burden associated with the new disclosure requirements will be experienced during the first year as language is developed and trading documentation is amended. After the new representations are developed and incorporated into trading documentation, the Commission believes that the annual paperwork burden associated with this requirement would be no more than approximately 10 hours per counterparty for verifying representations with existing counterparties and onboarding new counterparties, for a maximum of approximately 150 hours across all applicable security-based swap counterparties.[785]

C. Reliance on Counterparty Representations Regarding Non-U.S. Person Status

1. Summary of Collection of Information

When determining whether its counterparty is a U.S. person for purposes of the application of the dealer and major participant analyses, a person may rely on its counterparty's

[785] The Commission staff estimates that this burden would consist of 10 hours of in-house counsel time for each security-based swap market participant that may make such representations.

representation that the counterparty does not meet the applicable criteria to be a U.S. person, unless the person knows or has reason to know that the representation is not accurate.[786]

2. Proposed Use of Information

Under the final rules, a non-U.S. person's dealer and major participant analysis require it to determine whether its security-based swap counterparties are U.S. persons because certain security-based swaps in which the counterparty is not a U.S. person will not have to be counted against the applicable thresholds.

The Commission recognizes that the "U.S. person" definition encompasses a number of distinct components, and that in some circumstances verifying whether a security-based swap counterparty is a "U.S. person" could require significant due diligence. As a result, the final rules have added a representation provision to that definition, to help mitigate the operational difficulties and costs that could arise in connection with investigating the status of a counterparty.

As with the representations associated with the "transaction conducted through a foreign branch" definition, these representations would be provided voluntarily by the counterparties to certain security-based swap transactions to other counterparties. The Commission would not typically receive confidential information as a result of this collection of information. However, to the extent that the Commission receives confidential information described in this representation provision through our examination and oversight program, an investigation, or some other means, such information would be kept confidential, subject to the provisions of applicable law.[787]

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786 See Exchange Act rule 3a71-3(a)(4)(iv).

787 See note 782, supra.

3. Respondents

Based on our understanding of the OTC derivatives markets, including the domiciles of counterparties that are active in the market, the Commission estimates that up to 2400 entities may provide representations that they do not meet the criteria necessary to be U.S. persons.[788]

4. Total Initial and Annual Reporting and Recordkeeping Burdens

The estimates in this section reflect the Commission's experience with burden estimates for similar requirements and discussions by our staff with market participants. Consistent with the discussion above related to the representation provision of the "transaction conducted through a foreign branch" definition, the Commission believes that in most cases the representations associated with the "U.S. person" definition would be made through amendments to the parties' existing trading documentation (e.g., the schedule to a master agreement).[789] Here too, because these representations relate to new regulatory requirements, the Commission anticipates that counterparties may elect to develop and incorporate these representations in trading documentation soon after the effective date of the Commission's security-based swap regulations, rather than incorporating specific language on a transactional basis. The Commission believes that parties would be able to adopt, where appropriate, standardized language across all of their security-based swap trading relationships. This language may be

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788 Data regarding activity from 2012 indicates that a total of 4452 accounts had positions in single-name CDS, with those activities conducted by a total 1030 transacting agents such as investment advisers. Of those 4452 accounts, 1199 are domiciled outside of the United States. Accounting for potential growth in the number of market participants domiciled outside of the United States – particularly in light of information suggesting there has been some shifting of derivatives activities to non-U.S. entities – leads to our estimate that such representations may be made on behalf of 2400 accounts. To the extent that one transacting agent such as an investment adviser conducts derivatives activities on behalf of multiple accounts, it is possible that a single representation by a transacting agent would address the U.S.-person status of multiple accounts.

789 See section IV.E.2, supra.

developed by individual firms or through a combination of trade associations and industry working groups.

As above, the Commission estimates the maximum total paperwork burden associated with developing new representations would be, for each counterparty that may make such representations, no more than five hours and up to $2,000 for the services of outside professionals, for a maximum of approximately 12,000 hours and $4.8 million across all security-based swap counterparties that may make such representations. This estimate assumes little or no reliance on standardized disclosure language.

The Commission expects that the majority of the burden associated with the new disclosure requirements will be experienced during the first year as language is developed and trading documentation is amended. After the new representations are developed and incorporated into trading documentation, the Commission believes that the annual paperwork burden associated with this requirement would be no more than approximately 10 hours per counterparty for verifying representations with existing counterparties and onboarding new counterparties, for a maximum of approximately 24,000 hours across all applicable security-based swap counterparties.[790]

X. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA")[791] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) of the Administrative Procedure Act,[792] as amended by the RFA, generally requires the Commission to

790 The Commission staff estimates that this burden would consist of 10 hours of in-house counsel time for each security-based swap market participant that may make such representations.

791 5 U.S.C. 601 et seq.

792 5 U.S.C. 603(a).

undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."[793] Section 605(b) of the RFA[794] provides that this requirement shall not apply to any proposed rule or proposed rule amendment which, if adopted, would not have a significant economic impact on a substantial number of small entities.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less;[795] or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,[796] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[797] Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (i) for entities engaged in credit intermediation and related activities,

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793 Although section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10 under the Exchange Act, 17 CFR 240.0-10. See Exchange Act Release No. 18451 (Jan, 28, 1982), 47 FR 5215 (Feb, 4, 1982) (File No. AS-305).

794 5 U.S.C. 605(b).

795 See 17 CFR 240.0-10(a).

796 17 CFR 240.17a-5(d).

797 See 17 CFR 240.0-10(c).

entities with $175 million or less in assets;[798] (ii) for entities engaged in non-depository credit intermediation and certain other activities, entities with $7 million or less in annual receipts;[799] (iii) for entities engaged in financial investments and related activities, entities with $7 million or less in annual receipts;[800] (iv) for insurance carriers and entities engaged in related activities, entities with $7 million or less in annual receipts;[801] and (v) for funds, trusts, and other financial vehicles, entities with $7 million or less in annual receipts.[802]

The Cross-Border Proposal stated that, based on feedback from industry participants and our own information about the security-based swap markets, we preliminarily believed that non-U.S. entities that would be required to register and be regulated as security-based swap dealers and major security-based swap participants exceed the thresholds defining "small entities" set out above. Thus, we noted that we preliminarily believed it is unlikely that the proposed rules regarding registration of security-based swap dealers and major security-based swap market participants would have a significant economic impact any small entity. As a result, we certified that the proposed rules would not have a significant economic impact on a substantial number of small entities for purposes of the RFA and requested written comments regarding this certification.[803]

While we received comment letters that addressed cost issues in connection with the proposed rules, we did not receive any comments that specifically addressed whether the rules

798 . See 13 CFR 121.201 (Subsector 522).

799 See id. at Subsector 522.

800 See id. at Subsector 523.

801 See id. at Subsector 524.

802 See id. at Subsector 525.

803 See Cross-Border Proposing Release, 78 FR at 31205.

applying the definitions of "security-based swap dealer" or "major security-based swap participant" to the cross-border context would have a significant economic impact on small entities.

We continue to believe that the types of entities that would engage in more than a de minimis amount of dealing activity involving security-based swaps—which generally would be major banks—would not be "small entities" for purposes of the RFA. Similarly, we believe that only the largest financial companies would be likely to develop security-based swap exposures of the size that would be required to cross the major security-based swap participant definition thresholds. Accordingly, the SEC certifies that the final rules applying the definitions of "security-based swap dealer" or "major security-based swap participant" to the cross-border context will not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

XI. Effective Date and Implementation

These final rules will be effective 60 days following publication in the Federal Register.

If any provision of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Because Exchange Act rules 3a67-10 and 3a71-3 through 3a71-5 address the application of the dealer and major participant definitions to cross-border security-based swap activities, those rules will not immediately impose requirements upon market participants even after the rules become effective. In the Intermediary Definitions Adopting Release, we noted that because the Commission has not yet promulgated final rules implementing the substantive requirements imposed on dealers and major participants by Title VII, persons determined to be dealers or

major participants under the regulations adopted in that release need not register as such until the dates provided in the Commission's final rules regarding security-based swap dealer and major security-based swap participant registration requirements, and will not be subject to the requirements applicable to those dealers and major participants until the dates provided in the applicable final rules.[804] Those principles apply here too.

Although Exchange Act rule 0-13 – regarding the procedures for the submission of substituted compliance requests – also will become effective at that time, we would not expect to receive any such requests until relevant substantive rulemakings have been completed. Those rulemakings are necessary to determine when substituted compliance may be available, and to promulgate the requirements against which we may assess comparability for purposes of making substituted compliance determinations.

Statutory Authority and Text of Final Rules

Pursuant to the Exchange Act, 15 U.S.C. 78a et seq., and particularly, sections 3(b), 23(a)(1), and 30(c) thereof, sections 761(b), and 929P(b) of the Dodd-Frank Act, the SEC is adopting rules 0-13, 3a67-10, 3a71-3, 3a71-4, and 3a71-5 under the Exchange Act, and the SEC is adding Part 250 to chapter II of Title 17 of the Code of Federal Regulations.

List of Subjects in 17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

List of Subjects in 17 CFR Parts 241 and 250

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804 See Intermediary Definitions Adopting Release, 77 FR at 30700. We also noted that an extended compliance period was available with regard to the applicable thresholds used in the de minimis exception to the dealer definition. See id.; see also section III.A, supra.

Securities.

Text of Final Rules

For the reasons stated in the preamble, the SEC is amending Title 17, Chapter II of the Code of Federal Regulations as follows:

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

1. The general authority citation for part 240 continues to read, and a sectional authority is added in numerical order to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

Sections 240.3a67-10, 240.3a71-3, 240.3a71-4, and 240.3a71-5 are also issued under Pub. L. 111-203, § 761(b), 124 Stat. 1754 (2010), and 15 U.S.C. 78dd(c).

* * * * *

2. Add § 240.0-13 to read as follows:

§ 240.0-13 Commission procedures for filing applications to request a substituted compliance order under the Exchange Act.

(a) The application shall be in writing in the form of a letter, must include any supporting documents necessary to make the application complete, and otherwise must comply with §

240.0-3. All applications must be submitted to the Office of the Secretary of the Commission, by a party that potentially would comply with requirements under the Exchange Act pursuant to a substituted compliance order, or by the relevant foreign financial regulatory authority or authorities. If an application is incomplete, the Commission may request that the application be withdrawn unless the applicant can justify, based on all the facts and circumstances, why supporting materials have not been submitted and undertakes to submit the omitted materials promptly.

(b) An applicant may submit a request electronically. The electronic mailbox to use for these applications is described on the Commission's website at www.sec.gov in the "Exchange Act Substituted Compliance Applications" section. In the event electronic mailboxes are revised in the future, applicants can find the appropriate mailbox by accessing the "Electronic Mailboxes at the Commission" section.

(c) All filings and submissions filed pursuant to this rule must be in the English language. If a filing or submission filed pursuant to this rule requires the inclusion of a document that is in a foreign language, a party must submit instead a fair and accurate English translation of the entire foreign language document. A party may submit a copy of the unabridged foreign language document when including an English translation of a foreign language document in a filing or submission filed pursuant to this rule. A party must provide a copy of any foreign language document upon the request of Commission staff.

(d) An applicant also may submit a request in paper format. Five copies of every paper application and every amendment to such an application must be submitted to the Office of the Secretary at 100 F Street, NE, Washington, DC 20549-1090. Applications must be on white paper no larger than 8½ by 11 inches in size. The left margin of applications must be at least 1½

inches wide, and if the application is bound, it must be bound on the left side. All typewritten or printed material must be set forth in black ink so as to permit photocopying.

(e) Every application (electronic or paper) must contain the name, address, telephone number, and email address of each applicant and the name, address, telephone number, and email address of a person to whom any questions regarding the application should be directed. The Commission will not consider hypothetical or anonymous requests for a substituted compliance order. Each applicant shall provide the Commission with any supporting documentation it believes necessary for the Commission to make such determination, including information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor and enforce compliance with such rules. Applicants should also cite to and discuss applicable precedent.

(f) Amendments to the application should be prepared and submitted as set forth in these procedures and should be marked to show what changes have been made.

(g) After the filing is complete, the staff will review the application. Once all questions and issues have been answered to the satisfaction of the staff, the staff will make an appropriate recommendation to the Commission. After consideration of the recommendation and a vote by the Commission, the Commission's Office of the Secretary will issue an appropriate response and will notify the applicant.

(h) The Commission shall publish in the Federal Register a notice that a complete application has been submitted. The notice will provide that any person may, within the period specified therein, submit to the Commission any information that relates to the Commission action requested in the application. The notice also will indicate the earliest date on which the

Commission would take final action on the application, but in no event would such action be taken earlier than 25 days following publication of the notice in the Federal Register.

(i) The Commission may, in its sole discretion, schedule a hearing on the matter addressed by the application.

3. Add § 240-3a67-10 to read as follows:

§ 240.3a67-10 Foreign major security-based swap participants.

(a) Definitions. As used in this section, the following terms shall have the meanings indicated:

(1) Conduit affiliate has the meaning set forth in § 240.3a71-3(a)(1).

(2) Foreign branch has the meaning set forth in § 240.3a71-3(a)(2).

(3) Transaction conducted through a foreign branch has the meaning set forth in § 240.3a71-3(a)(3).

(4) U.S. person has the meaning set forth in § 240.3a71-3(a)(4).

(b) Application of major security-based swap participant tests in the cross-border context. For purposes of calculating a person's status as a major security-based swap participant as defined in section 3(a)(67) of the Act (15 U.S.C. 78c(a)(67)), and the rules and regulations thereunder, a person shall include the following security-based swap positions:

(1) If such person is a U.S. person, all security-based swap positions that are entered into by the person, including positions entered into through a foreign branch;

(2) If such person is a conduit affiliate, all security-based swap positions that are entered into by the person; and

(3) If such person is a non-U.S. person other than a conduit affiliate, all of the following types of security-based swap positions that are entered into by the person:

(i) Security-based swap positions that are entered into with a U.S. person; provided, however, that this paragraph (i) shall not apply to:

(A) Positions with a U.S. person counterparty that arise from transactions conducted through a foreign branch of the counterparty, when the counterparty is a registered security-based swap dealer; and

(B) Positions with a U.S. person counterparty that arise from transactions conducted through a foreign branch of the counterparty, when the transaction is entered into prior to 60 days following the earliest date on which the registration of security-based swap dealers is first required pursuant to the applicable final rules and regulations; and

(ii) Security-based swap positions for which the non-U.S. person's counterparty to the security-based swap has rights of recourse against a U.S. person; for these purposes a counterparty has rights of recourse against the U.S. person if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap.

(c) Attributed positions.

(1) In general. For purposes of calculating a person's status as a major security-based swap participant as defined in section 3(a)(67) of the Act (15 U.S.C. 78c(a)(67)), and the rules and regulations thereunder, a person also shall include the following security-based swap positions:

(i) If such person is a U.S. person, any security-based swap position of a non-U.S. person for which the non-U.S. person's counterparty to the security-based swap has rights of recourse against that U.S. person.

Note to paragraph (c)(1)(i). This paragraph describes attribution requirements for a U.S. person solely with respect to the guarantee of the obligations of a non-U.S. person under a security-based swap. The Commission and the Commodity Futures Trading Commission previously provided an interpretation about attribution to a U.S. parent, other affiliate, or guarantor to the extent that the counterparties to those positions have recourse against that parent, other affiliate, or guarantor in connection with the position. See Intermediary Definitions Adopting Release, http://www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf. The Commission explained that it intended to issue separate releases addressing the application of the major participant definition, and Title VII generally, to non-U.S. persons. See id. at note 1041.

(ii) If such person is a non-U.S. person:

(A) Any security-based swap position of a U.S. person for which that person's counterparty has rights of recourse against the non-U.S. person; and

(B) Any security-based swap position of another non-U.S. person entered into with a U.S. person counterparty who has rights of recourse against the first non-U.S. person, provided, however, that this paragraph (B) shall not apply to positions described in § 240.3a67-10(b)(3)(i)(A) and (B).

(2) Exceptions. Notwithstanding paragraph (c)(1) of this section, a person shall not include such security-based swap positions if the person whose performance is guaranteed in connection with the security-based swap is:

(i) Subject to capital regulation by the Commission or the Commodity Futures Trading Commission (including, but not limited to regulation as a swap dealer, major swap participant, security-based swap dealer, major security-based swap participant, futures commission merchant, broker, or dealer);

(ii) Regulated as a bank in the United States;

(iii) Subject to capital standards, adopted by the person's home country supervisor, that are consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision; or

(iv) Deemed not to be a major security-based swap participant pursuant to § 240.3a67-8(a).

4. Add §§ 240.3a71-3, 240.3a71-4, and 240.3a71-5 to read as follows:

Sec.
240.3a71-3 Cross-border security-based swap dealing activity.
240.3a71-4 Exception from aggregation for affiliated groups with registered security-based swap dealers.
240.3a71-5 Substituted compliance for foreign security-based swap dealers.

* * * * *

§ 240.3a71-3 Cross-border security-based swap dealing activity.

(a) Definitions. As used in this section, the following terms shall have the meanings indicated:

(1) Conduit affiliate--

(i) Definition. Conduit affiliate means a person, other than a U.S. person, that:

(A) Is directly or indirectly majority-owned by one or more U.S. persons; and

(B) In the regular course of business enters into security-based swaps with one or more other non-U.S. persons, or with foreign branches of U.S. banks that are registered as security-based swap dealers, for the purpose of hedging or mitigating risks faced by, or otherwise taking positions on behalf of, one or more U.S. persons (other than U.S. persons that are registered as security-based swap dealers or major security-based swap participants) who are controlling, controlled by, or under common control with the person, and enters into offsetting security-based

swaps or other arrangements with such U.S. persons to transfer risks and benefits of those security-based swaps.

(ii) Majority-ownership standard. The majority-ownership standard in paragraph (a)(1)(i)(A) of this section is satisfied if one or more persons described in § 240.3a71-3(a)(4)(i)(B) directly or indirectly own a majority interest in the non-U.S. person, where "majority interest" is the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership.

(2) Foreign branch means any branch of a U.S. bank if:

(i) The branch is located outside the United States;

(ii) The branch operates for valid business reasons; and

(iii) The branch is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where located.

(3) Transaction conducted through a foreign branch--

(i) Definition. Transaction conducted through a foreign branch means a security-based swap transaction that is arranged, negotiated, and executed by a U.S. person through a foreign branch of such U.S. person if:

(A) The foreign branch is the counterparty to such security-based swap transaction; and

(B) The security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States.

(ii) Representations. A person shall not be required to consider its counterparty's activity in connection with paragraph (a)(3)(i)(B) of this section in determining whether a security-based

swap transaction is a transaction conducted through a foreign branch if such person receives a representation from its counterparty that the security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States, unless such person knows or has reason to know that the representation is not accurate; for the purposes of this final rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.

(4) U.S. person--

(i) Except as provided in paragraph (a)(4)(iii) of this section, U.S. person means any person that is:

(A) A natural person resident in the United States;

(B) A partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;

(C) An account (whether discretionary or non-discretionary) of a U.S. person; or

(D) An estate of a decedent who was a resident of the United States at the time of death.

(ii) For purposes of this section, principal place of business means the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. With respect to an externally managed investment vehicle, this location is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.

(iii) The term U.S. person does not include the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank,

the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies and pension plans.

(iv) A person shall not be required to consider its counterparty to a security-based swap to be a U.S. person if such person receives a representation from the counterparty that the counterparty does not satisfy the criteria set forth in paragraph (a)(4)(i) of this section, unless such person knows or has reason to know that the representation is not accurate; for the purposes of this final rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.

(5) United States means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

(b) Application of de minimis exception to cross-border dealing activity. For purposes of calculating the amount of security-based swap positions connected with dealing activity under § 240.3a71-2(a)(1), except as provided in § 240.3a71-5, a person shall include the following security-based swap transactions:

(1)(i) If such person is a U.S. person, all security-based swap transactions connected with the dealing activity in which such person engages, including transactions conducted through a foreign branch;

(ii) If such person is a conduit affiliate, all security-based swap transactions connected with the dealing activity in which such person engages; and

(iii) If such person is a non-U.S. person other than a conduit affiliate, all of the following types of transactions:

(A) Security-based swap transactions connected with the dealing activity in which such person engages that are entered into with a U.S. person; provided, however, that this paragraph (A) shall not apply to:

(1) Transactions with a U.S. person counterparty that constitute transactions conducted through a foreign branch of the counterparty, when the counterparty is a registered security-based swap dealer; and

(2) Transactions with a U.S. person counterparty that constitute transactions conducted through a foreign branch of the counterparty, when the transaction is entered into prior to 60 days following the earliest date on which the registration of security-based swap dealers is first required pursuant to the applicable final rules and regulations; and

(B) Security-based swap transactions connected with the dealing activity in which such person engages for which the counterparty to the security-based swap has rights of recourse against a U.S. person that is controlling, controlled by, or under common control with the non-U.S. person; for these purposes a counterparty has rights of recourse against the U.S. person if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap; and

(2) If such person engages in transactions described in paragraph (b)(1) of this section, except as provided in § 240.3a71-4, all of the following types of security-based swap transactions:

(i) Security-based swap transactions connected with the dealing activity in which any U.S. person controlling, controlled by, or under common control with such person engages, including transactions conducted through a foreign branch;

(ii) Security-based swap transactions connected with the dealing activity in which any conduit affiliate controlling, controlled by, or under common control with such person engages; and

(iii) Security-based swap transactions connected with the dealing activity of any non-U.S. person, other than a conduit affiliate, that is controlling, controlled by, or under common control with such person, that are described in paragraph (b)(1)(iii) of this section.

§ 240.3a71-4 Exception from aggregation for affiliated groups with registered security-based swap dealers.

Notwithstanding §§ 240.3a71-2(a)(1) and 240.3a71-3(b)(2), a person shall not include the security-based swap transactions of another person (an "affiliate") controlling, controlled by, or under common control with such person where such affiliate either is:

(a) Registered with the Commission as a security-based swap dealer; or

(b) Deemed not to be a security-based swap dealer pursuant to § 240.3a71-2(b).

§ 240.3a71-5 Exception for cleared transactions executed on a swap execution facility.

(a) For purposes of § 240.3a71-3(b)(1), a non-U.S. person, other than a conduit affiliate, shall not include its security-based swap transactions that are entered into anonymously on an execution facility or national securities exchange and are cleared through a clearing agency; and

(b) For purposes of § 240.3a71-3(b)(2), a person shall not include security-based swap transactions of an affiliated non-U.S. person, other than a conduit affiliate, when such transactions are entered into anonymously on an execution facility or national securities exchange and are cleared through a clearing agency.

PART 241—INTERPRETIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

5. Part 241 is amended by adding Release No. 34-72472 to the list of interpretive releases as follows:

Subject	Release No.	Date	Fed. Reg. Vol. .and Page
Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities	34-72472	June 25, 2014	79 FR [Insert FR Page Number]

6. Part 250 is added to read as follows:

PART 250 – CROSS-BORDER ANTIFRAUD LAW-ENFORCEMENT AUTHORITY

Authority: 15 U.S.C. 77s, 77v(c), 78w, 78aa(b), 80b-11, and 80b-14(b).

§ 250.1 Cross-border antifraud law-enforcement authority.

(a) Notwithstanding any other Commission rule or regulation, the antifraud provisions of the securities laws apply to:

(1) Conduct within the United States that constitutes significant steps in furtherance of the violation; or

(2) Conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

(b) The antifraud provisions of the securities laws apply to conduct described in paragraph (a)(1) of this section even if:

(1) The violation relates to a securities transaction or securities transactions occurring outside the United States that involves only foreign investors; or

(2) The violation is committed by a foreign adviser and involves only foreign investors.

(c) Violations of the antifraud provisions of the securities laws described in this section may be pursued in judicial proceedings brought by the Commission or the United States.

By the Commission.

Kevin M. O'Neill
Deputy Secretary

Date: June 25, 2014

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72463 / June 25, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3863 / June 25, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15944

In the Matter of

THOMAS H. REDMOND, JR.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Thomas H. Redmond, 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 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. Redmond, operating as Faith Financial Planners of Indiana, LLC, and/or Velocity Wealth Management LLC, was, during most of the period between January 2004, and May 2012, either a registered representative associated with Commission-registered broker-dealers and/or an investment adviser representative affiliated with Commission-registered investment advisers. Redmond, 62 years old, is presently incarcerated at the Indiana Miami Correctional Facility located in Bunker Hill, Indiana.

2. The State of Indiana's criminal information filed against Redmond alleged, inter alia, that he, between January 2004 and May 2012 and in connection with the offer and sale of securities, misappropriated investor funds, falsely stated to investors that their funds were invested in securities, sent out false account statements indicating that investors funds were invested in securities and earning returns, and otherwise engaged in conduct which operated as a fraud and deceit on investors. The criminal information also alleged that Redmond failed to inform at least two investors that he had been barred by the Financial Industry Regulatory Authority, Inc. (FINRA) in 2011 from selling securities.

3. On or about July 18, 2013, Redmond pled guilty to eight counts of class B felony securities fraud and two counts of class C felony securities fraud before the Marion County [Indiana] Superior Court-Criminal Division, in The State of Indiana v. Thomas Redmond, Jr., (Cause No. 49G06-1304-FB-021154). Redmond was sentenced the same day to 15 years, 10 years executed, and to pay restitution totaling $460,121.25.

4. The counts of the criminal information to which Redmond pled guilty alleged, inter alia, that Redmond, in connection with the offer or sale of a security, directly or indirectly employed a device, scheme or artifice to defraud, and/or engaged in an act, practice or course of business that operates or would operate as a fraud or deceit upon 10 investors.

IV.

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

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a

broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9606 / June 25, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72471 / June 25, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3560 / June 25, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15946

In the Matter of

JEFFREY C. KUEHR AND MICHAEL J. WILLOUGHBY,

Respondents.

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, CEASE-AND-DESIST ORDERS, AND PENALTIES

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Jeffrey C. Kuehr ("Kuehr") and Michael J. Willoughby ("Willoughby) (collectively, the "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 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, Cease-And-Desist Orders, and Penalties, as set forth below.

III.

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

SUMMARY

This proceeding arises from the misconduct of the Respondents and Thomas A. Neely, Jr., ("Neely") while employed by Regions Bank and its parent holding corporation, Regions Financial Corporation ("Regions"). During the quarter ended March 31, 2009, in accordance with Regions' policies and procedures, personnel within Regions Bank's Special Asset Department ("SAD") who reported up to the Respondents, initiated the procedures to place approximately $168 million of certain commercial loans (the "Loans") into non-accrual status. In March 2009, the Respondents and Neely, arbitrarily and without supporting documentation, took steps to keep the Loans in accrual status. Such steps by the Respondents and Neely to evade existing policies and procedures constituted a fraudulent scheme, prevented Regions from appropriately measuring impairment in accordance with Generally Accepted Accounting Principles ("GAAP"), rendered Regions' financial statements for the quarter ended March 31, 2009 materially misstated and not prepared in conformity with GAAP, and evidenced a failure by Regions to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the Loans were recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

RESPONDENTS

1. Jeffrey C. Kuehr, 50, was formerly an Executive Vice President and the head of Regions' SAD. During the relevant period, Kuehr reported to Willoughby who at the time was Regions' Chief Credit Officer ("CCO"). Kuehr's employment with Regions concluded on December 29, 2010.

2. Michael J. Willoughby, 68, was formerly a Senior Executive Vice President and Regions' CCO. As CCO, Willoughby directly reported to Regions' Chief Risk Officer. Willoughby's employment with Regions concluded on November 30, 2010.

RELATED PERSON AND ENTITY

3. Thomas A. Neely, Jr., 53, was formerly an Executive Vice President for Regions' Risk Management Credit Division where he reported to Willoughby. Neely also oversaw Regions' Risk Analytics Group and together with Kuehr functionally controlled Regions' SAD. Neely's employment with Regions concluded on November 30, 2010.

4. Regions Financial Corporation is a Delaware financial holding corporation headquartered in Birmingham, Alabama. Regions conducts its banking operations through its subsidiary Regions Bank, which is a member of the Federal Reserve System. Regions' common stock is registered with the Commission pursuant to Section 12(b) of the Securities Act and trades

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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.

on the New York Stock Exchange under the symbol "RF." As of December 31, 2013, Regions had approximately $117 billion in assets.

FACTS

Regions' Tracking of Non-Accrual Loans

5. Throughout the relevant time-period, including the quarter ended March 31, 2009, Region's tracked and recorded its non-performing loans ("NPLs") as part of both internal performance metrics and its regular financial reporting. NPLs at Regions primarily consisted of loans in a non-accrual status. [2]

6. Regions' policies and procedures required that loans be placed on non-accrual status when it was determined that payment of all contractual principal and interest was in doubt, or the loan was past due 90 days or more as to principal and interest, unless the loan was well-secured and in the process of collection. When a loan was placed in non-accrual status, uncollected interest accrued during the current year would be reversed and reduce Regions' interest income. In addition, placing a loan on non-accrual status served as a trigger for Regions to consider whether the specific loan was impaired and thus how to determine an allowance for loan and lease losses in accordance with GAAP.

7. Regions' policies and procedures provided that the decision to place a loan in non-accrual status was to be made by Relationship Managers ("RMs") within SAD. RMs were responsible for reviewing loan file details, monitoring payments and communicating with borrowers. Under Regions' policies and procedures, RMs had the greatest degree of knowledge within SAD of the relevant loan status and a borrower's ability to make payments of principal and interest.

8. Regions' policies and procedures required that when RMs initiated an action to place a loan on non-accrual status, they would submit a supporting form to their regional manager that showed their conclusion and justified how they determined a loan should be placed in non-accrual status. Regions' policies and procedures then provided for the regional manager to conduct a detailed review of the loan with the responsible RM, after which the approval was granted by the regional manager.

9. Once approval for non-accrual classification was granted by the regional manager, Regions' policies and procedures specified that any subsequent exception to classifying the loan in non-accrual status was required to be fully documented and justified on an approved "Recommendation to Continue Accrual Status" form.

10. Once the RM and the regional manager recommended that a loan should be classified in non-accrual status, it was then listed by SAD managers in the Asset Quality Forecast report ("AQF"). The AQF identified which loans had been recommended by the RM and regional

[2] GAAP does not provide guidance regarding placing loans on a non-accrual status.

manager for being placed on non-accrual status, and it forecasted charge-offs and nonperforming assets for the quarter.

11. The AQF was a principal forecasting tool of SAD that was prepared under the direction of the Respondents and Neely. The AQF was discussed weekly at meetings regularly conducted and attended by the Respondents. Neely and Willoughby also regularly utilized the AQF in presentations to Regions' Executive Council, which consisted of, among others, Regions' Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), in discussing current trends in NPLs.

12. The SAD, under the control of the Respondents and Neely, had authority over the preparation, content, and dissemination of the AQF. Once a loan recommended for non-accrual status by the RMs and regional managers was included on the AQF, the responsible RMs would complete information required for a processing list and submit it to Regions' Risk Analytics Group. The processing list was designed as an electronic record documenting the specific actions for individual loans to be formally taken by Regions and reflected in Regions' accounting systems. Neely maintained final authority over the processing list. Following Neely's approval, his subordinates would submit the processing list for the identified loans to be recorded as non-accrual in Regions' accounting systems.

Respondents' Misclassification of Loans and Evasion of Regions' Policies and Procedures during the Quarter Ended March 31, 2009

13. As of the beginning of March 2009, Regions' AQF identified NPLs of approximately $1.6 billion. Kuehr, Neely and Willoughby had discussed between themselves the then current AQF and NPLs. The AQF and related NPLs tracking for the quarter were made available to Regions' CEO and CFO.

14. On or about March 13, 2009, Kuehr, Neely and Willoughby were informed by a subordinate that an error had resulted in an underreporting of NPLs by an amount approximating $200 million, or 13% as reported in the AQF data made available to Regions' CEO and CFO.

15. On or about March 17, 2009, Willoughby was actively tracking and calculating how NPLs could be decreased by approximately $200 million so as to more closely approach the previously identified NPL target.

16. On or about March 17, 2009, Neely suggested to Willoughby and Kuehr that a $6.8 commercial million loan be recorded as an accruing loan despite being recommended for non-accrual status by the assigned RM and regional manager. This loan was prevented by Neely, without objection from Willoughby and Kuehr, from being placed on the AQF or a processing list and was classified by Regions as being in accrual status as of March 31, 2009. Contrary to Regions' policies and procedures, Respondents prevented the subject loan from being classified as non-accrual without any documentation or justification.

17. On or about March 18, 2009, Neely and Willoughby instructed subordinates to take specific actions to remove from the AQF approximately $150 million of commercial loans

that had been recommended by the assigned RMs and regional managers, in accordance with Regions' policies and procedures, as being classified as non-accrual. Neely and Willoughby issued such instructions to their subordinates without any documentation or justification supporting the removal of these loans from the AQF, in direct contravention of Regions' policies and procedures. Kuehr, then head of SAD, thereafter was made aware of and did not object to this action by Neely and Willoughby. The ultimate effect of these instructions was the improper classification of the Loans, representing approximately $168 million, as being in accrual status. Had Regions classified the relevant loans on non-accrual status in accordance with its policies, it would have prompted a determination that the identified loans were impaired in accordance with GAAP. That determination would have resulted in Regions recording a higher allowance for loan and lease losses.

18. On or about March 23, 2009, Willoughby and Neely attended a meeting at which they provided false information regarding NPLs for the quarter to certain senior executives, including Regions' CFO.

19. In taking the undocumented and unjustified steps above, Respondents and Neely collectively circumvented Regions' policies and procedures regarding the classification of loans into non-accrual status. Respondents and Neely's scheme directly resulted in the improper classification of the Loans pursuant to Regions' policies, and further prevented Regions from appropriately determining those Loans were impaired in accordance with GAAP at the quarter ended March 31, 2009.

20. In accordance with Regions' policies and procedures, the Loans were required to have been classified in non-accrual status at the quarter ended March 31, 2009. Had Regions classified the Loans on non-accrual status with its policies, it would have prompted a determination that the Loans were impaired in accordance with Statement of Financial Accounting Standard No. 114, Accounting by Creditors for Impairment of a Loan ("SFAS No. 114").[3]

Impact of Respondents' Misconduct on Regions' Financial Statements

21. Respondents circumvented Regions' internal accounting controls through their recording and reporting of the Loans in a manner that was not in accordance with Regions' policies and procedures. As a result, Regions failed to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the Loans were recorded as necessary to permit preparation of financial statements in conformity with GAAP.

22. Respondents' misconduct resulted in Regions' failing to make and keep books, records, and accounts, in reasonable detail, which accurately and fairly reflected the Loans. Further, Regions' accounts were falsified through the misconduct of the Respondents.

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[3] See SFAS No. 114, which states that "a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement" and it requires lenders to measure impairment based on the present value of expected cash flows or an observable fair value of the collateral (i.e., an appraisal) if the loan is collateral dependent.

23. The books, records and accounts reflecting the Loans were incorporated into Regions' consolidated financial statements for the quarter ended March 31, 2009. As a result of failing to properly account for the Loans in accordance with GAAP, for the quarter ended March 31, 2009, Regions' income before income taxes was overstated by $16 million, its net income applicable to common shareholders was overstated by approximately $11 million, and its earnings per common share was overstated by approximately $.02 per share.

24. The above misstatements were included in Regions' April 21, 2009 press release included in its Form 8-K dated April 21, 2009 and filed with the Commission on April 21, 2009, in its exhibits to its Form 8-K dated May 20, 2009 and filed with the Commission on May 20, 2009, in its March 31, 2009 Form 10-Q filed May 11, 2009, and two subsequent amendments to its March 31, 2009 Form 10-Q filed on May 13, 2009 and June 9, 2009, in a Form S-4 filed on May 20, 2009 and in three subsequent amendments to this registration statement on May 22, 2009, June 4, 2009, and June 9, 2009, and in a Form S-8 filed on August 28, 2009 (collectively, the "Public Filings").

25. The Public Filings did not include other information as was necessary to ensure that the statements made in the Public Filings were not, under the circumstances, materially misleading.

26. The Respondents, through false statements and/or misleading omissions in sub-certification letters they signed in April 2009 in connection with the preparation of the reports on Form 10-Q above, misled Regions' Controller and Chief Accounting Officer and its Director of Internal Audit, both accountants, regarding Regions' books, records, accounts, and internal controls.

VIOLATIONS

27. Section 17(a) of the Securities Act prohibits any person, in the offer or sale of any security, from using the means and instrumentalities of interstate commerce and of the mails, directly or indirectly, to: (a) employ any device, scheme, or artifice to defraud; (b) obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (c) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

28. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit fraudulent conduct in connection with the purchase or sale of securities.

29. Section 20(b) of the Exchange Act makes it unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the Exchange Act or any rule or regulation thereunder through or by means of any other person.

30. Section 13(a) of the Exchange Act and Rules 13a-11, 13a-13 and 12b-20 thereunder, requires every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and current and quarterly reports as the Commission may require, and mandate that current and periodic reports contain such further material information as may be necessary to make the required statements not misleading.

31. Section 13(b)(2)(A) of the Exchange Act requires reporting companies to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

32. Section 13(b)(2)(B) of the Exchange Act requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP.

33. Section 13(b)(5) of the Exchange Act prohibits any person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls, and from knowingly falsifying any book, record, or account, required under Section 13(b)(2) of the Exchange Act.

34. Rule 13b2-1 of the Exchange Act prohibits any person from directly or indirectly falsifying or causing to be falsified any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

35. Rule 13b2-2 of the Exchange Act prohibits, among other things, officers of issuers from directly or indirectly making or causing to be made a materially false or misleading statement, or omitting to state any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to an accountant in connection with any quarterly review or the preparation or filing of any document or report required to be filed with the Commission.

36. As a result of the Respondents' scheme to misclassify the Loans as in accrual status as of the quarter ended March 31, 2009, the Respondents violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities, and Exchange Act Section 10(b) and Rule 10b-5 thereunder, which prohibits fraudulent conduct in connection with the purchase or sale of securities.

37. As a result of the conduct described above, the Respondents acted through Regions to make material misrepresentations in the Public Filings, and as a result, violated Sections 20(b) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

38. As a result of the conduct described above, the Respondents caused Regions to violate Section 13(a) of the Exchange Act and Rules 13a-11, 13a-13 and 12b-20 thereunder because its financial statements for the quarter ended March 31, 2009, included in current and quarterly reports, failed to record the Loans in conformity with GAAP.

39. As a result of the conduct described above, the Respondents caused Regions to violate Section 13(b)(2)(A) of the Exchange Act because it did not keep books, records or accounts that accurately reflected the Loans.

40. As a result of the conduct described above, the Respondents caused Regions to violate Section 13(b)(2)(B) of the Exchange Act because it failed to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the Loans were recorded as necessary to permit preparation of its financial statements in accordance with GAAP.

41. As a result of the conduct described above, the Respondents violated Section 13(b)(5) of the Exchange Act when they knowingly circumvented Regions' system of internal accounting controls and knowingly falsified Regions' books, records, and accounts related to the Loans.

42. As a result of the conduct described above, the Respondents violated Rule 13b2-1 of the Exchange Act by directly or indirectly falsifying or causing to be falsified Regions' books, records and accounts relating to the Loans, which were subject to Section 13(b)(2)(A) of the Exchange Act.

43. As a result of the conduct described above, the Respondents violated Rule 13b2-2 of the Exchange Act when they directly or indirectly made or caused to be made materially false or misleading statements, or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to accountants in connection with the preparation or filing of documents and reports which were required to be filed with the Commission.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Respondent Kuehr 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, including committing or causing any such violations directly or indirectly through or by means of any other person, as prohibited by Section 20(b) of the Exchange Act, and cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 12b-20, 13a-11, 13a-13, 13b2-1, and 13b2-2 thereunder.

B. Respondent Kuehr be, and hereby is prohibited for a period of five (5) years from entry of this Order, from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

C. Respondent Kuehr shall pay a civil money penalty in the amount of $70,000 to the Securities and Exchange Commission. Payment shall be made in the following installments: $5,833.37 is due on the first of the month following entry of this Order, followed by eleven (11) additional payments of $5,833.33 due on the first of each consecutive following month,

constituting twelve (12) payments totaling $70,000. Payment of the entire remaining balance may be made at any point in time on or before it would otherwise be due under the terms of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance, plus any additional interest accrued 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 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 Jeffrey C. Kuehr 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 Aaron W. Lipson, Division of Enforcement, Securities and Exchange Commission, 950 East Paces Ferry Road, N.E., Atlanta, GA 30326-1382.

D. Respondent Willoughby 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, including committing or causing any such violations directly or indirectly through or by means of any other person, as prohibited by Section 20(b) of the Exchange Act, and 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), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 12b-20, 13a-11, 13a-13, 13b2-1, and 13b2-2 thereunder.

E. Respondent Willoughby be, and hereby is prohibited for a period of five (5) years from entry of this Order, from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

F. Respondent Willoughby shall pay a civil money penalty in the amount of $70,000 to the Securities and Exchange Commission. Payment shall be made in the following installments: $5,833.37 is due on the first of the month following entry of this Order, followed by eleven (11) additional payments of $5,833.33 due on the first of each consecutive following month, constituting twelve (12) payments totaling $70,000. Payment of the entire remaining balance may be made at any point in time on or before it would otherwise be due under the terms of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance, plus any additional interest accrued 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 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 Michael J. Willoughby 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 Aaron W. Lipson, Division of Enforcement, Securities and Exchange Commission, 950 East Paces Ferry Road, N.E., Atlanta, GA 30326-1382.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72475 / June 25, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15947

In the Matter of Brooklin Systems, Inc., Hartman & Associates, Inc., Kona Coast Systems, Inc., MiddleBrook Pharmaceuticals, Inc., and Southfield Energy Corp., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Brooklin Systems, Inc., Hartman & Associates, Inc., Kona Coast Systems, Inc., MiddleBrook Pharmaceuticals, Inc., and Southfield Energy Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Brooklin Systems, Inc. (CIK No. 1461901) is a revoked Nevada corporation located in Washington, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Brooklin Systems is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010.

2. Hartman & Associates, Inc. (CIK No. 1462360) is a revoked Nevada corporation located in Washington, Virginia with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). Hartman & Associates is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010.

3. Kona Coast Systems, Inc. (CIK No. 1461912) is a forfeited Delaware corporation located in Washington, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Kona Coast Systems is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010.

4. MiddleBrook Pharmaceuticals, Inc. (CIK No. 1161924) is a dissolved Delaware corporation located in Westlake, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MiddleBrook Pharmaceuticals is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010, which reported a net loss of over $15 million for the prior three months.

5. Southfield Energy Corp. (CIK No. 1409941) is a revoked Nevada corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Southfield Energy 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, 2010, which reported a net loss of $440,916 for the prior six months.

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].

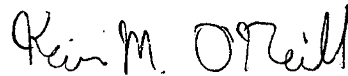
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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.



Kevin M. O'Neill
Deputy Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72476 / June 25, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15948

In the Matter of **THEODORE R. MALONEY, Esq.** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

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

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

herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Maloney, age 52, is and has been an attorney licensed to practice in the State of California. He is a Wyoming resident living in Jackson, Wyoming. He served as Chief Executive Officer of MediCor, Ltd. ("MediCor") from approximately September 2003 until April 2007.

2. MediCor was, at all relevant times, a Delaware corporation with its principal place of business in Las Vegas, Nevada. MediCor was engaged in the business of developing and manufacturing breast implants and other medical devices. At all relevant times, MediCor's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the OTC Bulletin Boards.

3. On January 14, 2011, the Commission filed a complaint against Maloney in SEC v. Theodore R. Maloney (Civil Action No. 02:11-cv-00075-JAD-VCF) in the District Court for the District of Nevada. On March 28, 2014, the Court entered an order permanently enjoining Maloney by consent from future violations of Sections 10(b), 13(b)(5), and 14(a) of the Exchange Act and Rules 10b-5, 13b2-2(a), and 14a-9 thereunder, and aiding and abetting violations of Sections 10(b), 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, and 13a-13 thereunder. Maloney was also ordered to pay a $100,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that from 2004 through 2006, Maloney prepared, approved and signed financial reports, proxy statements and management representation letters that he knew, or was reckless in not knowing, were materially false and misleading because they falsely stated that MediCor was being funded primarily through its chairman's personal wealth or legitimate transactions with an affiliate controlled by the chairman's family. Maloney allegedly knew that MediCor's chairman could not afford to fund the company and that, in truth, the primary source of MediCor's funding was money removed from a separate company controlled by MediCor's chairman, named Southwest Exchange Corporation ("Southwest"). Southwest was a "qualified intermediary" under Section 1031 of the Internal Revenue Code. The complaint specifically alleged that Maloney helped MediCor's chairman to remove approximately $45 million from Southwest in 2004 to be used for an acquisition on MediCor's behalf. The complaint also alleged that Maloney knew that MediCor's chairman continued to use moneys appropriated from Southwest to fund MediCor in 2005 and 2006. When the real estate market deteriorated in 2006, Southwest collapsed and was unable to repay

approximately $97 million owed to its clients. MediCor lost its primary source of funding and declared bankruptcy in June 2007.

IV.

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

Accordingly, it is hereby ORDERED, pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, effective immediately, that:

A. Maloney is suspended from appearing or practicing before the Commission as an attorney for five years from the date of the Order.

B. After five years (or 60 months) from the date of the Order, Respondent may request that the Commission consider his application to resume appearing and practicing before the Commission as an attorney. The application should be sent to the attention of the Office of General Counsel.

C. In support of such an application, Respondent must provide a certificate of good standing from each state bar where Respondent is a member.

D. In support of such an application, Respondent must also submit an affidavit truthfully stating, under penalty of perjury:

1. that Respondent has complied with the Order;

2. that Respondent:

    a. is not currently suspended or disbarred as an attorney by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession; and

    b. since the entry of the Order, has not been suspended as an attorney for an offense involving moral turpitude by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession, except for any suspension concerning the conduct that was the basis for the Order;

3. that Respondent, since the entry of the Order, has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and

4. that Respondent, since the entry of the Order:

   a. has not been found by the Commission or a court of the United States to have committed a violation of the federal securities laws, except for any finding concerning the conduct that was the basis for the Order;

   b. has not been charged by the Commission or the United States with a violation of the federal securities laws, except for any charge concerning the conduct that was the basis for the Order;

   c. has not been found by a court of the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, to have committed an offense involving moral turpitude, except for any finding concerning the conduct that was the basis for the Order; and

   d. has not been charged by the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, with having committed an offense involving moral turpitude, except for any charge concerning the conduct that was the basis for the Order.

E. If Respondent provides the documentation required in Paragraphs C and D, and the Commission determines that he truthfully attested to each of the items required in his affidavit, he shall by Commission order be permitted to resume appearing and practicing before the Commission as an attorney.

F. If Respondent is not able to truthfully attest to the statements required in Subparagraphs D(2)(b) or D(4), Respondent shall provide an explanation as to the facts and circumstances pertaining to the matter and the Commission may hold a hearing to determine whether there is good cause to permit him to resume appearing and practicing before the Commission as an attorney.

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9605 / June 25, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72470 / June 25, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3559 / June 25, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15945

In the Matter of THOMAS A. NEELY, JR., Respondent.	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDING PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that a cease-and-desist proceeding be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Thomas A. Neely, Jr. ("Respondent" or "Neely").

II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

This proceeding arises from the intentional misconduct of the Respondent while employed by Regions Bank and its parent holding corporation, Regions Financial Corporation ("Regions"). During the quarter ended March 31, 2009, in accordance with Regions' policies and procedures, personnel within Regions Bank's Special Asset Department ("SAD") who reported up to the Respondent, initiated the procedures to place approximately $168 million of certain commercial loans (the "Loans") into non-accrual status. In March 2009, the Respondent, arbitrarily and without supporting documentation, took intentional steps to keep the Loans in accrual status. The deliberate misclassification under its policies prevented Regions from appropriately measuring impairment in accordance with Generally Accepted Accounting Principles ("GAAP"). Such

deliberate misconduct by the Respondent to evade existing policies and procedures constituted a fraudulent scheme that rendered Regions' financial statements for the quarter ended March 31, 2009 materially misstated and not in conformity GAAP, and caused a failure by Regions to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the Loans were recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

A. RESPONDENT

1. Thomas A. Neely, Jr., 53, was formerly an Executive Vice President for Regions' Risk Management Credit Division, where he reported to Michael J. Willoughby. Neely also oversaw Regions' Risk Analytics Group and together with Jeffrey C. Kuehr functionally controlled Regions' SAD. Neely's employment with Regions terminated on November 30, 2010.

B. OTHER RELEVANT PERSONS AND ENTITY

2. Jeffrey C. Kuehr, 50, was formerly an Executive Vice President and the head of Regions' SAD. During the relevant period, Kuehr reported to Willoughby who at the time was Regions' Chief Credit Officer ("CCO"). Kuehr's employment with Regions terminated on December 29, 2010.

3. Michael J. Willoughby, 68, was formerly a Senior Executive Vice President and Regions' CCO. As CCO, Willoughby directly reported to Regions' Chief Risk Officer. Willoughby's employment with Regions terminated on November 30, 2010.

4. Regions Financial Corporation is a Delaware financial holding corporation headquartered in Birmingham, Alabama. Regions conducts its banking operations through its subsidiary Regions Bank, which is a member of the Federal Reserve System. Regions' common stock is registered with the Commission pursuant to Section 12(b) of the Securities Act and trades on the New York Stock Exchange under the symbol "RF." As of December 31, 2013, Regions had approximately $117 billion in assets.

C. REGIONS' TRACKING OF NON-ACCRUAL LOANS

5. Throughout the relevant time-period, including the quarter ended March 31, 2009, Region's tracked and recorded its non-performing loans ("NPLs") as part of both internal performance metrics and its regular financial reporting. NPLs at Regions primarily consisted of loans in a non-accrual status.[1]

6. Regions' policies and procedures required that loans be placed on non-accrual status when it was determined that payment of all contractual principal and interest was in doubt, or the loan was past due 90 days or more as to principal and interest, unless the loan was well-secured and in the process of collection. When a loan was placed in non-accrual status, uncollected interest that had accrued during the current year would be reversed, reducing Regions' interest income. In addition, placing a loan on non-accrual status served as a trigger for Regions to

[1] GAAP does not provide guidance regarding placing loans on a non-accrual status.

consider whether that specific loan was impaired and thus how to determine an allowance for loan and lease losses in accordance with GAAP.

7. Regions' policies and procedures provided that the decision to place a loan in non-accrual status was to be made by Relationship Managers ("RMs") within SAD. RMs were responsible for reviewing loan file details, monitoring payments and communicating with borrowers. Under Regions' policies and procedures, RMs had the greatest degree of knowledge within SAD of the relevant loan status and a borrower's ability to make payments of principal and interest.

8. Regions' policies and procedures required that when RMs initiated an action to place a loan on non-accrual status, they would submit a supporting form to their regional manager that showed their conclusion and justified how they determined a loan should be placed in non-accrual status. Regions' policies and procedures then provided for the regional manager to conduct a detailed review of the loan with the responsible RM, after which the approval was granted by the regional manager.

9. Once approval for non-accrual classification was granted by the regional manager, Regions' policies and procedures specified that any subsequent exception to classifying the loan in non-accrual status was required to be fully documented and justified on an approved "Recommendation to Continue Accrual Status" form and a signed "Risk Rating Change" form.

10. Once the RM and the regional manager concluded that a loan should be classified in non-accrual status, it was then listed by SAD managers in the Asset Quality Forecast report ("AQF"). The AQF identified which loans had been approved by the RM and regional manager for being placed on non-accrual status, and it forecasted charge-offs and nonperforming assets for the quarter.

11. The AQF was a principal forecasting tool of SAD that was prepared under the direction of the Respondent. The AQF was discussed weekly at meetings regularly conducted and attended by the Respondent. Neely and Willoughby also regularly utilized the AQF in presentations to Regions' Executive Council, which consisted of, among others, Regions' Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), in discussing current trends in NPLs.

12. The SAD, under the control of Kuehr and Neely, had authority over the preparation, content, and dissemination of the AQF. Once a loan recommended for non-accrual status by the RMs and regional managers was included on the AQF, the responsible RMs would complete information required for a processing list and submit it to Regions' Risk Analytics Group. The processing list was designed as an electronic record documenting the specific actions for individual loans to be formally taken by Regions and reflected in Regions' accounting systems. Neely maintained final authority over the processing list. Following Neely's approval, his subordinates would submit the processing list for the identified loans to be recorded as non-accrual in Regions' accounting systems.

D. NEELY'S INTENTIONAL MISCLASSIFICATION OF THE LOANS AND EVASION OF REGIONS' POLICIES AND PROCEDURES DURING THE QUARTER ENDED MARCH 31, 2009

13. As of the beginning of March 2009, Regions' AQF identified NPLs of approximately $1.6 billion. Neely had discussed with Kuehr and Willoughby the then current AQF and NPLs. The AQF and related NPLs tracking for the quarter were made available to Regions' CEO and CFO.

14. On or about March 13, 2009, Kuehr, Neely and Willoughby were informed by a subordinate that an error had resulted in an underreporting of NPLs by an amount approximating $200 million, or 13% as reported in the AQF data made available to Regions' CEO and CFO.

15. In a March 17, 2009 email to Willoughby and Kuehr, Neely recommended that a $6.8 commercial million loan be recorded as an accruing loan despite being recommended for non-accrual status by the assigned RM and regional manager. Based on Neely's recommendation, this loan was not placed on the AQF or a processing list and was improperly classified by Regions as being in accrual status as of March 31, 2009. The failure to document the justification for this action was contrary to Regions' policies and procedures.

16. On or about March 18, 2009, Neely and Willoughby instructed subordinates to take specific actions to remove from the AQF approximately $150 million of commercial loans that had been recommended by the assigned RMs and regional managers, in accordance with Regions' policies and procedures, as being classified as non-accrual. Neely and Willoughby issued such instructions to their subordinates without any documentation or justification supporting the removal of these loans from the AQF. The failure to provide justification or documentation violated Regions' policies and procedures. As a result, Regions improperly classified $168 million of the Loans as being in accrual status. Had Regions classified the relevant loans on non-accrual status in accordance with its policies, it would have prompted a determination that the identified loans were impaired in accordance with GAAP. That determination would have resulted in Regions recording a higher allowance for loan and lease losses.

17. On or about March 23, 2009, Willoughby and Neely attended a meeting at which they knowingly provided understated NPL data for the quarter to certain senior executives, including Regions' CFO.

18. In accordance with Regions' policies and procedures, the Loans were required to have been classified in non-accrual status at the quarter ended March 31, 2009. Had Regions classified the relevant loans on non-accrual status in accordance with its policies, it would have prompted a determination that the Loans were impaired in accordance with Statement of Financial Accounting Standard No. 114, Accounting by Creditors for Impairment of a Loan ("SFAS No. 114").[2]

[2] See SFAS No. 114, which states that "a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement" and it requires lenders to measure impairment based on the present value of expected cash flows or an observable fair value of the collateral (i.e., an appraisal) if the loan is collateral dependent.

19. In taking the undocumented and unjustified steps above, Neely intentionally circumvented Regions' policies and procedures regarding the classification of loans into non-accrual status. Neely's intentional scheme directly resulted in the improper classification of the Loans pursuant to Regions' policies, and further prevented Regions' from appropriately determining those Loans were impaired in accordance with GAAP at the quarter ended March 31, 2009.

E. INTENTIONAL MISCLASSIFICATION OF LOANS HELD FOR SALE

20. As part of his responsibilities at Regions, Neely had final approval to accept bids for loan sales. On or about March 16, 2009, Neely contacted a third-party in an effort to sell a $24.7 million commercial loan (the "Shopped Loan"), which was one of the Loans. A potential buyer immediately responded to Neely's solicitation, offering to buy the Shopped Loan for between 35 and 50 cents-on-the-dollar. Neely responded to the buyer that the offer was not sufficient. Neely responded to the potential buyer that Regions was looking for a price closer to 65 to 70 cents-on-the-dollar for the Shopped Loan, and asked the potential buyer to reconsider the recent offer to Regions.

21. On or about March 20, 2009, the potential buyer indicated that Neely's requested sale price for the Shopped Loan was too high.

22. On or about April 6, 2009, the potential buyer submitted an additional offer to purchase the Shopped Loan for 58.5% of the loan value.

23. On or about June 23, 2009, Regions, at Neely's direction, reclassified the Shopped Loan from loans held for investment to the "Loans Held for Sale" category with a related write-down to fair value.[3]

24. On or about September 2, 2009, the Shopped Loan was sold to a new buyer for 60% of its loan value.

25. In accordance with both GAAP and Regions' policies and procedures, the Shopped Loan was required to have been reclassified to "Loans Held for Sale," with a corresponding charge to earnings, prior to the close of the quarter ended March 31, 2009 because a decision to sell the loan had been made prior to the quarter end.

E. IMPACT OF NEELY'S INTENTIONAL MISCONDUCT ON REGIONS' FINANCIAL STATEMENTS

26. Regions' system of internal accounting controls was insufficient to provide reasonable assurances that the Loans were recorded as necessary to permit preparation of financial statements in conformity with GAAP.

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[3] See AICPA Statement of Position 01-6, Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others which states that once a decision has been made to sell loans not previously classified as "held for sale," such loans should be transferred into the "held-for-sale" account and reported at the lower of cost or fair value.

27. Neely intentionally circumvented Regions' existing internal accounting controls through his recording and reporting of the Loans in a manner that was not in accordance with Regions' policies and procedures.

28. Neely's intentional misconduct resulted in Regions' failing to make and keep books, records, and accounts, in reasonable detail, which accurately and fairly reflected the Loans. Further, Regions' accounts were falsified through the intentional misconduct of the Respondents.

29. The books, records and accounts reflecting the Loans were incorporated into Regions' consolidated financial statements for the quarter ended March 31, 2009. As a result of failing to properly account for the Loans in accordance with GAAP, for the quarter ended March 31, 2009, Regions' income before income taxes was overstated by $16 million, its net income applicable to common shareholders was overstated by approximately $11 million, and its earnings per common share was overstated by approximately $.02 per share.

30. Had the Shopped Loan been properly written down to fair value in conformity with GAAP and Regions' policies and procedures, Regions' net income available to common shareholders would have been reduced an additional approximately $2.9 million beyond the approximate $11 million overstatement attributable to the Loans.

31. The above misstatements were included in Regions' April 21, 2009 press release included in its Form 8-K dated April 21, 2009 and filed with the Commission on April 21, 2009, in its exhibits to its Form 8-K dated May 20, 2009 and filed with the Commission on May 20, 2009, in its March 31, 2009 Form 10-Q filed May 11, 2009, and two subsequent amendments to its March 31, 2009 Form 10-Q filed on May 13, 2009 and June 9, 2009, in a Form S-4 filed on May 20, 2009 and in three subsequent amendments to this registration statement on May 22, 2009, June 4, 2009, and June 9, 2009, and in a Form S-8 filed on August 28, 2009 (collectively, the "Public Filings").

32. The Public Filings did not include other information as was necessary to ensure that the statements made in the Public Filings were not, under the circumstances, materially misleading.

33. In connection with Regions' financial reporting for the quarter ended March 31, 2009, Neely executed a sub-certification provided to Regions' Controller and Chief Accounting Officer. Neely's knowingly made false statements and/or misleading omissions in the sub-certification when he averred that the was "not aware of ... [a]ny significant deficiencies in the ... internal control over financial reporting ... [or] [a]ny fraud, whether or not material." Neely knew that the sub-certification would be relied on as part of the financial reporting process for the quarter.

F. CONDUCT FOLLOWING THE QUARTER ENDED MARCH 31, 2009

34. On or about May 14, 2009, Neely instructed a subordinate to change the name of an internal SAD document to falsely reflect that RMs, and not Neely as in fact occurred, had recommended that the Loans remain in accrual status at March 31, 2009. Neely took additional actions to conceal his prior conduct regarding the Loans from personnel at Regions as well as Regions Bank's regulators.

G. VIOLATIONS

35. As a result of Neely's intentional scheme to misclassify the Loans as in accrual status and to prevent the Shopped Loan from being classified in "Loans Held for Sale" as of the quarter ended March 31, 2009, Neely violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities, and Exchange Act Section 10(b) and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

36. As a result of the conduct described above, Neely acted through Regions to make material misrepresentations in the Public Filings, and as a result, Neely violated Sections 20(b) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

37. As a result of the conduct described above, Neely aided and abetted and caused Regions' violations of Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 thereunder of the Exchange Act.

38. As a result of the conduct described above, Neely caused Regions to violate Section 13(a) of the Exchange Act and Rules 13a-11, 13a-13 and 12b-20 thereunder because its financial statements for the quarter ended March 31, 2009 included in current and quarterly reports, failed to record the Loans and the Shopped Loan in conformity with GAAP.

39. As a result of the conduct described above, Neely caused Regions to violate Section 13(b)(2)(A) of the Exchange Act because it did not keep books, records or accounts that accurately reflected the Loans and the Shopped Loan.

40. As a result of the conduct described above, Neely caused Regions to violate Section 13(b)(2)(B) of the Exchange Act because it failed to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the Loans and the Shopped Loan were recorded as necessary to permit preparation of its financial statements in accordance with GAAP.

41. As a result of the conduct described above, Neely violated Section 13(b)(5) of the Exchange Act when he knowingly circumvented and knowingly falsified Regions' books, records, and accounts related to the Loans and the Shopped Loan.

42. As a result of the conduct described above, Neely violated Rule 13b2-1 of the Exchange Act by directly or indirectly falsifying or causing to be falsified Regions' books, records and accounts relating to the Loans and the Shopped Loan which were subject to Section 13(b)(2)(A) of the Exchange Act.

43. As a result of the conduct described above, Neely violated Rule 13b2-2 of the Exchange Act when he directly or indirectly made or caused to be made materially false or misleading statements, or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to accountants in connection with the preparation or filing of documents and reports which were required to be filed with the Commission.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it appropriate that a cease-and-desist proceeding 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. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, including committing or causing any such violations directly or indirectly through or by means of any other person, as prohibited by Section 20(b) of the Exchange Act, Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 12b-20, 13a-11, 13a-13, 13b2-1, and 13b2-2 thereunder, whether Respondent should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act and Section 21B(a) of the Exchange Act, and whether pursuant to Section 21C(f) of the Exchange Act, Respondent should be 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.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Jill M. Peterson
Assistant Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 72485 / June 26, 2014

Admin. Proc. File No. 3-15017

In the Matter of the Application of

NICHOLAS S. SAVVA and HUNTER SCOTT
FINANCIAL, LLC
c/o Michael Schwartzberg, Esq.
Winget, Spadafora & Schwartzberg, LLP
45 Broadway, 19th Floor
New York, New York 10006

For Review of Action Taken by
FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DENIAL OF MEMBERSHIP CONTINUANCE APPLICATION

Registered securities association denied member firm's application to permit continued association of an individual who was subject to a statutory disqualification because of his consent to a 2004 final order of a state regulatory authority based on violations of laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct. *Held*, the review proceeding is *dismissed.*

APPEARANCES:

Michael Schwartzberg and *Steven E. Mellen*, of Winget, Spadafora & Schwartzberg, LLP, for Nicholas S. Savva and Hunter Scott Financial, LLC.

Alan Lawhead, *Michael J. Garawski*, and *Andrew J. Love*, for the Financial Industry Regulatory Authority, Inc.

Appeal filed: September 10, 2012
Last brief received: January 23, 2013

Hunter Scott Financial, LLC ("Hunter Scott" or the "Firm") and Nicholas S. Savva ("Savva") appeal from FINRA's[1] denial of Hunter Scott's MC-400 Membership Continuance Application ("MC-400 Application" or the "Application") requesting permission for Savva to continue his association with the Firm as a general securities representative notwithstanding that he was subject to a statutory disqualification under Section 3(a)(39)(F) of the Securities Exchange Act of 1934,[2] which is incorporated by reference in Article III, Section 4 of FINRA's By-Laws.[3] Savva became subject to a statutory disqualification because of his consent in 2004 to a final order of the Vermont State Department of Banking, Insurance, Securities and Health Care Administration (the "Vermont Department") based on violations of laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct in the securities business (the "Vermont Order").[4] On appeal, Hunter Scott and Savva contend that the Vermont Order was not a "final order" within the meaning of the Exchange Act's statutory disqualification provision, and that FINRA's denial of Hunter Scott's MC-400 Application was unfair.[5] For the reasons set forth below, we conclude that FINRA's denial of Hunter Scott's MC-400 Application was in

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1 In July 2007, the National Association of Securities Dealers, Inc. ("NASD") was consolidated with the regulatory arm of the New York Stock Exchange, LLC, resulting in the formation of the Financial Industry Regulatory Authority, Inc. ("FINRA"). *See* Securities Exchange Act Release No. 56148, 2007 WL 2159604, at *2 (July 26, 2007). Because this proceeding was instituted after consolidation, all references to FINRA will include references to NASD.

2 15 U.S.C. § 78c(a)(39)(F) (defining a "statutory disqualification" by reference to Exchange Act Section §15(b)(4)(H)(i) and (ii) and including certain final orders of state securities regulators).

3 FINRA By-Laws, Art. III, § 4 (stating that a person is subject to "disqualification" if such person is subject to "statutory disqualification" as defined in Exchange Act Section 3(a)(39) (formerly Art. II, § 4 of the FINRA By-Laws). The definition of "disqualification" in FINRA's By-Laws directly conforms to the definition of "statutory disqualification" in the Exchange Act. *See* Exchange Act Release No. 56145, 2007 WL 5185330, at *8 (July 26, 2007).

4 *Nicholas S. Savva*, No. 04-019-S, Order Imposing Administrative Sanctions and Consent to Same (Vt. Dep't of Banking, Ins., Sec. & Health Care Admin. Aug. 3, 2004). The Vermont Department was renamed the Vermont Department of Financial Regulation in 2012.

5 Hunter Scott and Savva are persons aggrieved by FINRA's denial of Hunter Scott's MC-400 Application. *See* 17 C.F.R. § 201.420 (providing that any person aggrieved by a FINRA denial of membership may file an application for Commission review); *cf. Leslie A. Arouh*, Exchange Act Release No. 62898, 2010 WL 3554584, at *1 (Sept. 13, 2010) (considering appeal by associated person from FINRA's denial of firm's membership continuance application).

accordance with its rules, and that those rules are, and were applied in a manner, consistent with the purposes of the Exchange Act, and we therefore dismiss this appeal.[6]

I. Background

A. Statutory disqualifications and FINRA's eligibility proceedings

A statutory disqualification constitutes an encumbrance to membership in, or association with a member of, a self-regulatory organization ("SRO"), but it does not necessarily preclude a person from participating in the securities industry.[7] Instead, a statutory disqualification can render a member or associated person ineligible to participate: a person subject to statutory disqualification cannot become or remain associated with a FINRA member firm unless the person's member firm applies for, and is granted, in FINRA's discretion, relief from the statutory disqualification.[8] A member firm can apply for relief from the statutory disqualification by filing an MC-400 Application, which initiates an eligibility proceeding.[9] The critical inquiry in every eligibility proceeding is whether the proposed or continued association of the person subject to disqualification would be consistent with the public interest and the overriding regulatory goal of

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6 Hunter Scott and Savva moved for a stay of FINRA's action pending appeal, but we denied the request. *See Nicholas S. Savva*, Order Denying Stay, Admin. Proc. File No. 3-15017 (Oct. 31, 2012).

7 *See Statutory Disqualification Review Process*, Audit No. 363 (May 13, 2003), *available at* http://www.sec.gov/about/oig/audit/363fin.htm. Events that subject a person to a statutory disqualification include, but are not limited to, certain misdemeanor convictions, all felony convictions, certain court injunctions, suspensions and bars ordered by the Commission or an SRO, and, as relevant here, certain final orders of state securities regulators. *See* 15 U.S.C. § 78c(a)(39).

8 FINRA By-Laws, Art. III, § 3(b), (d); *see Joseph S. Amundsen*, Exchange Act Release No. 69406, 2013 WL 1683914, at *1 n.4 (Apr. 18, 2013).

9 FINRA Rules 9520 to 9527 (the "FINRA Rule 9520 Series") set forth eligibility procedures pursuant to which FINRA may allow a person to become or remain associated with a member despite the existence of a statutory disqualification. In proceedings such as this one, after a member applies for relief, FINRA's Department of Member Regulation reviews the application and makes a recommendation to FINRA's Statutory Disqualification Committee. If the Department of Member Regulation recommends rejecting the application, the applicant may request a hearing. Following the hearing, the Hearing Panel makes a recommendation to the Statutory Disqualification Committee. The committee reviews the record and the Hearing Panel's recommendation and presents a recommendation to FINRA's National Adjudicatory Council (the "NAC"). The NAC's decision considers the request for relief, the recommendation, the public interest, and the protection of investors.

ensuring the protection of investors.[10] Denials of a member's application to permit the proposed or continued association of the person are reviewable by the Commission.[11]

The Sarbanes-Oxley Act of 2002 expanded the definition of "statutory disqualification" in Exchange Act Section 3(a)(39) by creating new categories of disqualification.[12] Under the expanded definition, a person is subject to statutory disqualification if the person is subject to a final order of a state securities regulator that either bars the person from association with an entity regulated by such a regulator or is based on violations of laws or regulations prohibiting fraudulent, manipulative, or deceptive conduct.[13] The statutory disqualifications in Exchange Act Section 3(a)(39) are not self-executing and must be implemented by an SRO through its own provisions. FINRA did not amend its By-Laws to implement the Sarbanes-Oxley Act's expanded definition of "statutory disqualification" until 2007, when FINRA made its By-Laws coextensive with Exchange Act Section 3(a)(39), such that any person who was subject to "statutory disqualification" under the Exchange Act also would be subject to "disqualification" under FINRA rules.[14]

In 2009, FINRA proposed, and the Commission approved, amendments to the eligibility proceedings—the FINRA Rule 9520 Series—to cover persons subject to disqualification as a result of the amended By-Laws.[15] Among other things, the amendments established eligibility proceedings for persons currently in the securities industry who were subject to disqualification

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[10] *See* http://www.finra.org/industry/enforcement/adjudication/nac/statutorydisqualificationprocess.

[11] *See supra* note 5.

[12] Pub. L. No. 107-204, 116 Stat. 745 (2002).

[13] 15 U.S.C. § 78*o*(b)(4)(H).

[14] *See* Exchange Act Release No. 56145, 2007 WL 5185330, at *8 (July 26, 2007), as amended by Exchange Act Release No. 56145A, 2008 WL 2677219 (May 30, 2008). From 2002 until 2007, FINRA's By-Laws and corresponding eligibility procedures subjected persons to disqualification based on certain events, including certain misdemeanor and felony criminal convictions for a period of ten years from the date of conviction, a temporary or permanent injunction issued by a court of competent jurisdiction, SRO expulsions, and bars ordered by the Commission and SROs. These By-Laws and procedures implemented the definition of "statutory disqualification" in Exchange Act Section 3(a)(39) as it existed before its amendment by the Sarbanes-Oxley Act.

[15] On July 27, 2007, FINRA sought, and the Commission granted, no-action relief for the transitional period from 2007, when the amended FINRA By-Laws became effective, to 2009, the effective date of the related eligibility procedures. FINRA requested this relief only with respect to notice filings for the "limited" number of persons whom FINRA proposed to admit to or continue in membership or association with a member notwithstanding disqualification as a result of the Sarbanes-Oxley Act. *See* NASD: No-Action Letter dated July 27, 2007, *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/2007/nasd072707-19h-1.htm.

as a result of the Sarbanes-Oxley Act.[16] In a notice to members describing the amendments, FINRA specified the circumstances under which members would be required to file a membership continuance application under the new eligibility rules.[17] In particular, and as relevant here, members had to file a membership continuance application to associate with persons who, as of March 17, 2009, were subject to a final order of a state regulator based on violations of laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct, or where the sanctions involved licensing or registration revocation or suspension (or analogous sanctions) and the sanctions were still in effect.

B. Savva's statutorily disqualifying event and Hunter Scott's application seeking Savva's continued association despite the disqualification

Savva has been employed in the securities industry as a registered representative since 1996. In January 2004, he became associated with Hunter Scott, a FINRA member with its main office in Delray Beach, Florida and branch offices in Florida and New York.[18] On August 17, 2009, Hunter Scott filed an MC-400 Application seeking FINRA's approval for Savva to continue his association with the Firm as a general securities representative notwithstanding that he was subject to a statutory disqualification. Hunter Scott filed the Application after FINRA's Department of Registration and Disclosure ("RAD") notified it on June 15, 2009 that Savva was subject to disqualification under Exchange Act Section 3(a)(39) as a result of his consent to a final order of the Vermont Department on August 3, 2004. RAD advised Hunter Scott of the need to either file an MC-400 Application seeking approval for Savva's continued association with the Firm or immediately terminate his employment (and file a Form U5 or Uniform Termination Notice for Securities Industry Registration).[19]

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[16] *See* Exchange Act Release No. 59586, 2009 WL 763690, at *1 (Mar. 17, 2009). In approving the amended eligibility procedures, the Commission stated that the changes were consistent with the Exchange Act's provisions because they would allow FINRA "to integrate filings mandated by the revised definition of disqualification into established programs that monitor subject persons and allow FINRA and the Commission to focus resources on filings that raise important investor protection concerns." *Id.* at *3.

[17] *See* FINRA Notice 09-19, 2009 WL 971688, at *3 (Apr. 9, 2009), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p118466.pdf.

[18] Hunter Scott placed Savva on heightened supervision in March 2004, after only two months on the job, because of customer complaints. Savva was also on heightened supervision while working for his prior employer J.P. Turner & Company ("J.P. Turner"). The specifics of J.P. Turner's heightened supervision plan are not part of the record.

[19] The MC-400 application form requests information about the terms and conditions of the proposed employment, with special emphasis on the proposed supervision to be accorded the disqualified person. The failure of the member to either terminate the person's employment or submit an MC-400 application may subject the member to a statutory disqualification. *See* http://www.finra.org/industry/enforcement/adjudication/nac/statutorydisqualificationprocess.

The Vermont Order found that from August 2002 until November 2003, while associated with his prior employer J.P. Turner and while on heightened supervision, Savva engaged in unauthorized transactions in customer accounts, made unsuitable recommendations to customers, and regularly used high pressure or "boiler room"[20] tactics to sell securities, in violation of provisions of the Vermont Securities Act.[21] Specifically, the Vermont Order alleged that Savva entered transactions in a customer's account without consulting the customer and without obtaining the customer's approval; recommended securities to customers without reasonable grounds to believe that the securities were suitable for the customers; recommended small capital, aggressive growth stocks without considering the customers' investment experience, investment objectives, or financial resources; regularly pressured customers to make hasty decisions to purchase securities that he was recommending; and coerced customers through repeated, rehearsed telephone calls to purchase securities and open accounts so that he could execute unauthorized transactions in those accounts.

Without admitting or denying Vermont's findings of fact or conclusions of law, Savva consented to a censure, a cease-and-desist order, and a $25,000 fine. He also agreed not to seek registration in Vermont as a broker-dealer sales representative or an investment adviser representative and agreed not to supervise any Vermont registered broker-dealer sales representative or investment adviser representative without the Vermont Department's prior written consent. He further agreed to waive his right to a hearing before the Commissioner of the Vermont Department and to all other procedures otherwise available to him under the Vermont Securities Act, any right to judicial review, and compliance with provisions of Vermont's Administrative Procedures Act applicable to contested cases.[22] Savva has not received relief from Vermont, nor has Vermont granted him permission to seek registration as a broker-dealer sales representative or an investment adviser representative or to supervise any registered broker-dealer sales representative or investment adviser representative.[23] As a result, the sanctions imposed on Savva remain in effect.

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[20] "A 'boiler-room' operation is characterized by numerous sales people making a high volume of telephone calls to previously unknown individuals and using high-pressure tactics to sell securities, often through the use of misrepresentations." *Vladimir Boris Bugarski*, Exchange Act Release No. 66842, 2012 WL 1377357, at *2 & n.8 (Apr. 20, 2012).

[21] *See* 9 V.S.A. §§ 4201 *et seq.*, Regulation S-91-1, §§ 3.03, 3.05, & 3.06, promulgated pursuant to 9 V.S.A. § 4221a(a)(8). After the events at issue, the Vermont Securities Act was repealed and superseded by the Vermont Uniform Securities Act, 9 V.S.A. §§ 5101 *et seq.*

[22] *See* 3 V.S.A. §§ 801 *et seq.* (Vermont Administrative Procedures Act).

[23] In October 2004, Vermont filed a Form U6 or Uniform Disciplinary Action Reporting Form to disclose the Vermont Order to FINRA's Central Registration Depository ("CRD") system. Form U6 is used by SROs and state and federal regulators to report disciplinary actions against broker-dealers and associated persons. *Disqualification of Felons and Other Bad Actors From Rule 506 Offerings*, Securities Act Release No. 9414, 2013 WL 3817311, at *22 n.135 (July 10, 2013). One of the questions on the Form U6 asked whether the Vermont Order "constitute[d] a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct." Vermont answered in the affirmative.

In the MC-400 Application, Hunter Scott proposed that Savva would work in its Brooklyn, New York office and that the manager of the Brooklyn office would supervise Savva. The Firm also represented that, in addition to its standard written supervisory procedures applicable to all registered personnel, Savva would continue to be subject to certain heightened supervisory procedures, which had been in place since March 2004.[24] Those heightened procedures required the Brooklyn manager to: (1) initial Savva's trade tickets prior to execution; (2) review Savva's customer account activity on a monthly basis with special attention to margin accounts and items such as extensions, liquidations, and trade corrections; (3) review Savva's new account forms to verify the accuracy and completeness of information contained in the forms; and (4) provide Savva with additional continuing education training on such topics as customer suitability and ethics.[25]

On June 29, 2011, FINRA's Department of Member Regulation ("Member Regulation") recommended to FINRA's Statutory Disqualification Committee that Savva's continued association with Hunter Scott be prohibited and that the Application be denied. A subcommittee of FINRA's Statutory Disqualification Committee thereafter informed the parties in writing that FINRA's Statutory Disqualification Committee found the alleged basis for Savva's disqualification to be "unclear," and requested supplemental briefing addressing whether Savva was disqualified because he was subject to a final order barring him from association, as described in Exchange Act Section 15(b)(4)(H)(i), or because he was subject to a final order based on violations of laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct, as described in Exchange Act Section 15(b)(4)(H)(ii). Both parties submitted briefs, with Member Regulation asserting that the Vermont Order was disqualifying under both provisions.

On November 17, 2011, a Hearing Panel consisting of a two-person subcommittee of FINRA's Statutory Disqualification Committee held a hearing at which Savva, the Brooklyn manager, and Hunter Scott's CCO testified.[26] Following the hearing, the Hearing Panel submitted a written recommendation to the Statutory Disqualification Committee, which considered the record and Hearing Panel's recommendation and presented its own written recommendation (to deny Hunter Scott's MC-400 Application) to the NAC for approval.[27]

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24 *See supra* note 18.

25 More than eight months after the hearing, but before the NAC issued a decision on the Application, Hunter Scott notified FINRA that it proposed to revise its supervisory plan and provide that Savva would work in the firm's Delray Beach office under the supervision of the Firm's Chief Compliance Officer ("CCO").

26 *See* FINRA Rule 9524(a)(1) (stating that when an applicant requests a hearing, "the National Adjudicatory Council or the Review Subcommittee shall appoint a Hearing Panel composed of two or more members, who . . . shall conduct a hearing and recommend a decision on the request for relief").

27 *See* FINRA Rule 9525(a)(10) ("On the basis of the record, the Hearing Panel shall present a recommended decision in writing on the request for relief to the Statutory Disqualification Committee. After considering the record and recommendation of the Hearing

(continued...)

C. FINRA's NAC denied Hunter Scott's MC-400 Application.

On August 10, 2012, the NAC denied Hunter Scott's MC-400 Application. The NAC found Savva's conduct underlying the Vermont Order to be "serious," "highly troubling," and "securities related." It also found that between 1999 and 2008 Savva was the subject of at least ten customer complaints relating to potential sales practice violations:

- August 1999–a customer sought $5,400 in damages based on allegations that Savva engaged in unauthorized trading and failed to execute trades in the customer's account. Savva personally settled the matter for $5,585.

- November 1999–a customer sought $166,000 in damages based on allegations that Savva engaged in unauthorized trading. Savva's then firm, J.P. Turner, settled the matter for $100,000, with Savva personally contributing $8,333 to the settlement.

- April 2000–a customer sought $5,057 in damages based on allegations that Savva charged excessive commissions. Savva personally paid between $1,500 and $4,000 to settle the matter.

- March 2003–a customer sought $31,000 in damages based on allegations that Savva improperly handled his account. J.P. Turner settled the matter for $19,980,[28] without Savva personally contributing to the settlement.

- April 2003–a customer sought $86,000 in damages based on allegations that Savva engaged in unauthorized trading, but the matter was subsequently dismissed.

- September 2003–a customer sought $60,000 in damages based on allegations that Savva engaged in excessive trading. J.P. Turner settled the matter for $24,000, without Savva personally contributing to the settlement.

- August 2005–a customer sought $47,000 in damages based on allegations that Savva charged excessive commissions. Hunter Scott settled the matter for $40,000, without Savva personally contributing to the settlement.

(...continued)
Panel, the Statutory Disqualification Committee shall present its recommended decision in writing to the National Adjudicatory Council."). The Hearing Panel's recommendations are not part of the record.

[28] In a written, post-hearing statement to the Hearing Panel, Savva reported that J.P. Turner settled the matter for $9,990, as opposed to the $19,980 disclosed on the CRD. FINRA did not find this discrepancy to be material; nor do we.

- June 2007–a customer sought $56,000 in damages based on allegations that Savva charged excessive commissions. Hunter Scott settled the matter for $37,000, without Savva personally contributing to the settlement.

- July 2007–a customer sought $45,057 in damages based on allegations that Savva, while at J.P. Turner, engaged in improper and unsuitable trading. J.P. Turner settled the matter for $9,995, without Savva personally contributing to the settlement.

- January 2008–a customer alleged that Savva engaged in an unauthorized transaction. Hunter Scott settled the matter for $2,284.

Of the ten customer complaints, three involved allegations of unauthorized transactions, and all ten resulted in either Savva or his firms paying a total of more than $240,000 to settle the complaints.

Along with the customer complaints, the NAC found that Savva was the subject of two regulatory matters. In November 2005, the State of Illinois required Savva to withdraw his registration and prohibited him from reapplying for registration for two years because he failed timely to update his Form U4 to reflect the November 1999 customer complaint described above. In April 2009, FINRA issued a Cautionary Action to Savva in connection with unsuitable recommendations in a customer's account and excessive trading.[29] The NAC stated that the ten customer complaints, coupled with the two regulatory matters, raised serious concerns about Savva's dealings with customers and his ability to comply with securities laws and regulations.

The NAC further found that Hunter Scott's proposed heightened supervision plan was inadequate. For instance, it did not contain procedures for reviewing and monitoring Savva's communications with customers, did not contain procedures for handling any future customer complaints against Savva, and did not designate a backup supervisor for Savva.

In addition, the NAC found that Hunter Scott failed to establish its ability to comply with the plan. Four of the ten customer complaints and the two regulatory matters arose while Savva was on heightened supervision. And, in April 2009, Hunter Scott received a Cautionary Action from FINRA for failing to follow its heightened supervision procedures with respect to Savva. Based on all the facts and circumstances, the NAC determined that Savva's continued association with Hunter Scott would not serve the public interest and would present an unreasonable risk of harm to the market or investors.

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[29] A Cautionary Action is a warning that similar violations in the future could result in formal disciplinary action. While Cautionary Actions are considered by FINRA staff in any future disciplinary action, they do not constitute formal discipline and are not reportable to the CRD or on Form BD (Uniform Application for Broker-Dealer Registration), the form used by entities to register as broker-dealers. *See* FINRA Regulatory Notice 09-17, 2009 WL 741194, at *2 (Mar. 18, 2009).

II. Analysis

A. Standard of Review

Section 19(f) of the Exchange Act establishes the criteria that govern our review of FINRA's denial of Hunter Scott's MC-400 Application.[30] We must dismiss Hunter Scott and Savva's appeal if we find that: the specific grounds on which FINRA based its action exist in fact; the denial was in accordance with FINRA's rules; and FINRA's rules are, and were applied in a manner, consistent with the Exchange Act's purposes.[31] Because we conclude that FINRA's denial of Hunter Scott's MC-400 Application satisfied these criteria, we dismiss this appeal.[32]

B. The specific grounds for FINRA's denial of Hunter Scott's MC-400 Application exist in fact.

We find that the specific grounds for FINRA's denial of Hunter Scott's MC-400 Application exist in fact. FINRA's By-Laws provide that a person is subject to "disqualification" if the person is subject to "statutory disqualification" under Exchange Act Section 3(a)(39).[33] Exchange Act Section 3(a)(39)(F) provides, in pertinent part, that a person is subject to a "statutory disqualification" with respect to membership or participation in, or association with a member of, an SRO if such person is subject to an order enumerated in Exchange Act Section 15(b)(4)(H),[34] including:

> any final order of a State securities commission (or any agency or officer performing like functions) [or] State authority that supervises or examines banks . . . that—
>
> (i) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or
>
> (ii) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.[35]

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30 15 U.S.C. § 78s(f).

31 *Id.*

32 Exchange Act Section 19(f) also requires us to set aside FINRA's action if we find that the action imposes an undue burden on competition. 15 U.S.C. § 78s(f). Hunter Scott and Savva do not claim, nor does the record support finding, that FINRA's actions impose such a burden.

33 *See supra* note 3.

34 15 U.S.C. § 78o(b)(4)(H).

35 *Id.*

The record shows that, pursuant to Exchange Act Section 15(b)(4)(H)(ii), Savva was subject to a statutory disqualification because he was subject to a final order of the Vermont Department, a state securities regulator, based on violations of laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.[36]

1. The Vermont Order was a "final order."

Exchange Act Section 15(b)(4)(H) encompasses final orders of state securities regulators, but does not indicate whether a consent order like the Vermont Order falls within the scope of the term "final order." Notwithstanding the potential statutory ambiguity, we believe that it is appropriate to construe "final order" under Exchange Act Section 15(b)(4)(H) to mean a written directive or declaratory statement issued by a state agency under statutory authority that provides for notice and opportunity for a hearing and constitutes a final disposition or action by the state agency.[37] We base this definition, in part, on the definition that FINRA uses in its uniform registration forms, which require broker-dealers and their associated persons to disclose final orders of state securities regulators.[38] The FINRA forms, which we approved in 2003,[39] define "final order" to mean "a written directive or declaratory statement issued by an appropriate federal or state agency . . . pursuant to applicable statutory authority and procedures[] that constitutes a final disposition or action by that federal or state agency."[40] In addition, we believe that, in the context of Exchange Act Section 15(b)(4)(H), the definition of "final order" should be limited to those orders issued under statutory authority providing for notice and an opportunity for a hearing, in order to address fundamental fairness concerns. Thus, our definition of "final order" under the Exchange Act is narrower that the definition in the FINRA forms because, for disqualification purposes, we are imposing a basic requirement that the state agency's statutory authority provide for notice and an opportunity for a hearing. Applying our definition here, we conclude that the Vermont Order was a "final order" under Exchange Act Section 15(b)(4)(H) because (1) it was a written directive issued by the Vermont Department that constituted a final

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36 *Id.* at § 78o(b)(4)(H)(ii). In light of this finding, we, like FINRA, do not decide whether the Vermont Order was also disqualifying under Exchange Act Section 15(b)(4)(H)(i).

37 We have not previously provided a definitive interpretation of the term "final order" in Section 15(b)(4)(H) of the Exchange Act. *Disqualification of Felons and Other Bad Actors From Rule 506 Offerings*, Securities Act Release No. 9211, 2011 WL 2045833, at *13 (May 28, 2011).

38 *Cf. id.* at *13 & n.53 (adopting the definition of "final order" used in FINRA registration forms in the context of promulgating disqualification rules implementing Section 926 of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act of 2010).

39 *See* Exchange Act Release No. 48161, 2003 WL 21635304 (July 10, 2003), corrected by Exchange Act Release No. 48161A, 2003 WL 21664202 (July 16, 2003).

40 *See* "Explanation of Terms" applicable to FINRA Forms U4, U5 and U6, *available at* http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p116979.pdf.

disposition of the securities law violations alleged against Savva,[41] and (2) the Vermont provisions provided notice and an opportunity for a hearing, which Savva waived when he consented to the imposition of administrative sanctions.[42]

Our definition of "final order" under the Exchange Act is consistent with the definition of "final order" that we adopted in the context of "essentially identical"[43] language in Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").[44] Like Exchange Act Section 15(b)(4)(H), Section 926 does not specify what constitutes a "final order" triggering disqualification,[45] so we later defined "final order" in Section 926 to mean "a written directive or declaratory statement issued by a federal or state agency . . . under

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41 *Cf. Bennett v. Spear*, 520 U.S. 154, 177 (1997) (holding that an order is final under the Administrative Procedure Act when it "mark[s] the consummation of the agency's decisionmaking process—it must not be of a merely tentative or interlocutory nature . . . [and] the action must be one by which rights or obligations have been determined, or from which legal consequences will flow"); *Amalgamated Clothing & Textile Workers Union v. SEC*, 15 F.3d 254, 257 (2d Cir. 1994) (holding that orders are final for purposes of Exchange Act Section 25(a) when they "impose an obligation, deny a right or fix some legal relationship as a consummation of the administrative process") (quoting *Chicago & S. Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103, 113 (1948)).

Vermont uses a similar definition of the term "final order," *see Jordan v. Vt. Agency of Transp*, 166 Vt. 509, 513, 702 A.2d 58, 61 (Vt. 1997) (stating that "[f]or an [administrative] order to be final, it must have disposed of all matters that should or could properly be settled at the time and in the proceeding then before the [decision-making body]") (internal quotations omitted), and, as previously noted, reported the Vermont Order as a final order on Form U6. *See supra* note 23.

42 *See* 9 V.S.A. § 4221a(a)(8) (stating that "[t]he commissioner, *subject to notice and opportunity for hearing* and in accordance with the procedures set forth in chapter 25 of Title 3 (Administrative Procedure Act), by order may deny, suspend, or revoke any registration, limit the securities or investment advisory activities that an applicant or registered person may perform in this state, bar an applicant or registered person from association with a registered broker-dealer or investment adviser, or a federal covered investment adviser, or bar from employment with a registered broker-dealer or investment adviser a person who is a partner, limited liability company member, officer, director, or a person occupying a similar status or performing a similar function for an applicant or registered person. Those actions may be taken on if the commissioner finds that the . . . registered person . . . : has engaged in unethical or dishonest practices in the securities business") (emphasis added).

43 *See Disqualification of Felons and Other Bad Actors From Rule 506 Offerings*, 2013 WL 3817311, at *22 & n.134.

44 Public Law No. 111-203, § 926, 124 Stat. 1376, 1851 (July 21, 2010).

45 *See Disqualification of Felons and Other Bad Actors From Rule 506 Offerings*, 2013 WL 3817311, at *22.

applicable statutory authority that provides for notice and an opportunity for a hearing, which constitutes a final disposition or action by that federal or state agency."[46]

Hunter Scott and Savva argue that consent orders and settlement agreements are not "final orders," but they provide no authority for this interpretation, and the cases they cite are inapposite.[47] We find that consenting to the entry of an order or settling charges would not justify excluding such an action from the definition of "final order."

There are several independent policy reasons for including consent orders and settlement agreements within the definition of "final order." For purposes of disqualification, it would not be in the public interest to restrict the definition of "final order" to orders entered only after a fully litigated hearing. Restricting the definition in this way could, among other things, cause parties to expend valuable resources litigating cases when settlement would have been preferable. Further, the distinction between final orders entered after litigation and those entered after settlement negotiation is arbitrary and could expose the public to a risk of harm from persons who would have been subject to disqualification had they not chosen to settle. Although this definition of "final order" includes consent orders and settlement agreements, it still serves to address basic due process and fairness concerns by requiring notice and an *opportunity* for a hearing, as opposed to requiring that a hearing actually take place.[48]

Hunter Scott and Savva also argue that a consent order with a "neither admit nor deny" provision cannot be used as a basis for disqualification under Exchange Act Section 15(b)(4)(H). To the contrary, the Commission's longstanding practice has been to use consent judgments or settlement orders containing such "no admit, no deny" language as a statutory basis for administrative proceedings under various provisions of the federal securities laws.[49] As we

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[46] *See* 17 C.F.R. § 501(g) (defining "final order" in Regulation D); *see also Disqualification of Felons and Other Bad Actors From Rule 506 Offerings*, 2013 WL 3817311, at *22.

[47] For instance, *SEC v. Pace*, 173 F. Supp. 2d 30 (D.D.C. 2001), concerned whether an issue had been adjudicated for purposes of claim preclusion. The district court found that the Commission was not precluded from asserting a fraud claim against the defendant based on a settlement in a tax court proceeding. *Id.* at 33-34. In *Beatrice Foods Co. v. FTC*, 540 F.2d 303 (7th Cir. 1976), the plaintiff corporation urged that a consent decree resolving another administrative action was a decision on the merits and thus binding on the Federal Trade Commission in determining the legality of the plaintiff's acquisition under antitrust laws. The court of appeals held that the consent decree was not binding. *Id.* at 312.

[48] We note that, in adopting a definition of "final order" in the context of disqualification rules implementing Section 926 of the Dodd-Frank Act, we considered whether settled cases should be treated the same as cases that were not settled. We stated that a settlement should be considered a "final order" if applicable provisions provide for notice and an opportunity for hearing. *Disqualification of Felons and Other Bad Actors From Rule 506 Offerings*, 2013 WL 3817311, at *23.

[49] *See* Securities Act Release No. 5337, 1972 WL 126309, at *1 (Nov. 28, 1972) and 17 C.F.R. § 202.5(e) ("announc[ing Commission] policy not to permit a defendant or respondent to

(continued...)

stated in *Marshall E. Melton*, "[d]efendants in Commission injunctive actions must understand that, if the Commission institutes an administrative proceeding against them based on an injunction to which they consented after issuance of this opinion, they may not dispute the factual allegations of the injunctive complaint in the administrative proceeding."[50] We further stated that "[f]or purposes of consent injunctions that are agreed to and entered by a court . . . , we will construe the 'neither admit nor deny' language as precluding a person who has consented to an injunction in a Commission enforcement action from denying the factual allegations of the injunctive complaint in a follow-on proceeding before this agency."[51] Hunter Scott and Savva do not address the *Melton* opinion or the Commission's longstanding practice in their briefs, nor do they offer any persuasive reason for us to deviate from that practice here.

2. The Vermont Order was based on violations of Vermont regulations prohibiting fraudulent, manipulative, or deceptive conduct.

We also find that the Vermont Order was based on violations of Vermont regulations prohibiting fraudulent, manipulative, or deceptive conduct.[52] The Vermont Order found that Savva violated Sections 3.03, 3.05, and 3.06 of Vermont Regulation S-91-1, promulgated pursuant to 9 V.S.A. § 4221a(a)(8) of the Vermont Securities Act. Section 3.03 prohibited, in

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(...continued)
consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings"); *see also, e.g., Marshall E. Melton*, Investment Adviser Act Release No. 2181, 56 SEC 695, 2003 WL 21729839, at *8 (July 25, 2003) ("[T]he Advisers Act and Exchange Act draw no distinction between injunctions entered after litigation or by consent. We do not believe that the statutes require the Enforcement Division to prove the allegations of an injunctive complaint in a follow-on administrative proceeding before any disciplinary action can be taken."); *Martin R. Kaiden*, Exchange Act Release No. 41629, 54 SEC 194, 1999 WL 507860, at *7 (July 20, 1999) ("Under Exchange Act Section 15(b)(6), we may institute administrative proceedings against an associated person of a broker-dealer based on an injunction from engaging in or continuing any conduct or practice in connection with acting as a broker-dealer."); *Kaye, Real & Co.*, Exchange Act Release No. 5226, 36 SEC 373, 1955 WL 43169, at *2 (Sept. 9, 1955) ("Under Section 15(b) of the [Exchange] Act, the mere issuance of the injunctions, the validity of which has not been attacked, furnishes a statutory basis for revocation if we find such action to be in the public interest.").

50 *Melton*, 2003 WL 21729839, at *9.

51 *Id.* at *8.

52 Hunter Scott and Savva argued before FINRA that the meaning of the phrase "fraudulent, manipulative, or deceptive conduct" was unclear and could be applied erroneously to violations that were merely "technical" in nature. FINRA disagreed, finding that Savva's alleged conduct underlying the Vermont Order was "serious" and not "technical" in nature. Hunter Scott and Savva do not renew their argument on appeal. In any event, we agree with FINRA that Savva's misconduct, involving unauthorized transactions, unsuitable recommendations, and the use of high-pressure sales tactics, was serious and not technical in nature.

pertinent part, "effecting a transaction in the account of a customer without authority to do so . . . ." Section 3.05 prohibited "recommending to a customer the purchase, sale or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's other securities holdings, investment objectives, financial situation and needs and any other relevant information known by the broker-dealer or sales representative." Section 3.06 prohibited "engaging or aiding in boiler room operations or high pressure tactics in connection with the solicitation of a sale or purchase of a security by means of an intensive telephone campaign or unsolicited calls to persons not known by, nor having an account with, the sales representative or broker-dealer represented by the sales representative, whereby the prospective purchaser is encouraged to make a hasty decision to buy, irrespective of his or her investment needs and objectives."

Vermont found that Savva violated these provisions by engaging in unauthorized customer transactions, making unsuitable customer recommendations, and engaging in high pressure sales tactics as part of a "boiler room" operation. Our cases have found that such business practices are, at a minimum, deceptive and violate antifraud provisions of the securities laws.[53] Accordingly, we conclude that the Vermont Order was disqualifying under Exchange Act Section 15(b)(4)(H)(ii) because Savva was found to have violated Vermont regulations prohibiting, at a minimum, deceptive practices in the securities business.[54]

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[53] *See, e.g., SEC v. Wolfson*, 539 F.3d 1249, 1252 n.6 (10th Cir. 2008) (explaining that "the term 'boiler room' is typically used to describe a telemarketing operation in which salespeople call lists of potential investors in order to peddle speculative or fraudulent securities. A broker using so-called 'boiler-room tactics' generally gives customers a high-pressure sales pitch containing misleading information about the nature of the investment, as well as the broker's own commission on the sale."); *SEC v. Hasho*, 784 F. Supp. 1059, 1110 (S.D.N.Y. 1992) (finding that defendants' unauthorized trades in connection with boiler room operations violated antifraud provisions because those trades were the result of material deception, misrepresentation or non-disclosure); *Martin Herer Engelman*, Exchange Act Release No. 35729, 52 SEC 271, 1995 WL 315515, at *1 (May 18, 1995) (finding that brokers' fraudulent conduct, "which was compounded by their use of high pressure sales tactics," included engaging in unauthorized trading in customer accounts and making unsuitable recommendations).

[54] We have stated that the phrase "fraudulent, manipulative or deceptive conduct" in Exchange Act Section 15(b)(4)(H) is not limited to scienter-based violations. *See Disqualification of Felons and Other Bad Acts From Rule 506 Offerings*, 2013 WL 3817311, at *25 (stating that Section 926 of the Dodd-Frank Act is not limited to matters involving scienter; Exchange Act Section 15(b)(4)(H), from which the language of Section 926 is drawn, does not contain a scienter requirement). Hunter Scott and Savva do not assert on appeal that Exchange Act Section 15(b)(4)(H) contains a scienter requirement.

C. FINRA's denial of Hunter Scott's MC-400 Application was in accordance with FINRA rules.

We also find that FINRA's denial of Hunter Scott's MC-400 Application was in accordance with FINRA rules. Among other things, FINRA conducted a hearing at which it afforded Savva an opportunity to be heard and to submit evidence and allowed Hunter Scott to submit a revised supervisory plan after the hearing.[55]

We reject each of the four arguments made by Hunter Scott and Savva in support of their position that FINRA misapplied its own rules, which, together with other actions, rendered the proceedings unfair. Hunter Scott and Savva contend that FINRA: (1) impermissibly and retroactively applied its 2009 amended eligibility proceedings to Savva; (2) failed to properly notify Savva of the basis for his disqualification; (3) erroneously admitted into evidence a transcript of the Vermont securities regulator's investigative interview of Savva; and (4) improperly delayed the institution and resolution of the proceedings. FINRA did not misapply its rules or otherwise deprive Savva of a fair proceeding.[56]

1. FINRA's application of its 2009 amended eligibility procedures to Savva was not impermissibly retroactive.

Hunter Scott and Savva argue that FINRA's application of its 2009 amended eligibility procedures to Savva was impermissibly retroactive because those procedures required Savva to submit to an eligibility proceeding when he was not required to do so before the amendment. We find that the application of the 2009 procedures to Savva was not impermissibly retroactive.

The U.S. Supreme Court has observed that "a statute 'is not made retroactive merely because it draws upon antecedent facts for its operation.'"[57] The Supreme Court has explained

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55 *See supra* note 25; *see also* FINRA By-Laws, Art. III, § 3(d) (stating that FINRA "may conduct such inquiry or investigation into the relevant facts and circumstances as it, in its discretion, considers necessary to its determination" of whether to approve a member's application for relief from ineligibility for membership).

56 We have held, and Hunter Scott and Savva do not dispute, that the fairness requirements of constitutional due process do not apply to FINRA proceedings because FINRA is not a state actor. *See, e.g., Eric J. Weiss*, Exchange Act Release No. 69177, 2013 WL 1122496, at *6 n.40 (Mar. 19, 2013) (citing cases). Nevertheless, the Exchange Act requires FINRA to provide fair procedures for its disciplinary proceedings. *See, e.g.*, 15 U.S.C. §§ 78*o*-3(b)(8), (h)(1). This obligation gives rise to "due-process-like" requirements. *D'Alessio v. SEC*, 380 F.3d 112, 121, 123 (2d Cir. 2004). Thus, we consider Hunter Scott's and Savva's arguments here in light of this statutory fairness requirement.

57 *Landgraf v. USI Film Prod.*, 511 U.S. 244, 270 n.24 (1994) (quoting *Cox v. Hart*, 260 U.S. 427, 435 (1922)); *see Vartelas v. Holder*, 132 S. Ct. 1479, 1487 (2012) (holding that a statute authorizing prospective remedies may consider conduct pre-dating the statute without having a genuinely retroactive effect).

that applying a new statute "passed after the events in suit is unquestionably proper"[58] when the statute "addresses dangers that arise post enactment."[59] This is the case even though such statutes "may unsettle expectations and impose burdens on past conduct."[60]

FINRA's application of the 2009 amended eligibility procedures to Savva did not have an impermissibly retroactive effect for two reasons. First, although the 2004 Vermont Order was the antecedent event that subjected Savva to disqualification (as a result of the Sarbanes-Oxley Act of 2002), the eligibility proceeding itself entailed an assessment of the *present* risk of future harm to investors and the markets that could be posed by Savva's continued participation in the securities industry.[61] Accordingly, while FINRA considered the conduct underlying the 2004 Vermont Order, FINRA also took into account other relevant facts and circumstances, including Savva's and Hunter Scott's arguments, the proposed plan of supervision, and evidence of Savva's conduct since 2004, such as the ten customer complaints and two regulatory matters. Thus, FINRA's determination that Savva would present an unreasonable risk of future harm to investors and the markets did not rest solely on the antecedent fact of the Vermont Order but on evidence relevant to an assessment of the current threat posed by Savva.

FINRA's determination is consistent with decisions from courts holding that administrative proceedings involving an assessment of a present risk of future harm are not impermissibly retroactive even where those proceedings are triggered by an antecedent event.[62] In *Boniface v. U.S. Department of Homeland Security*, for example, the Transportation Security Administration ("TSA") denied Boniface's application for a hazardous materials endorsement ("HME"), which was a prerequisite for renewing his commercial driver's license.[63] Although

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58 *Landgraf*, 511 U.S. at 273.

59 *Vartelas*, 132 S. Ct. at 1489 n.7; *see, e.g., Johnny Clifton*, Exchange Act Release No. 69982, 2013 WL 3487076, at *13 (July 12, 2013) (considering respondent's conduct predating the Dodd-Frank Act in assessing his future risk to the investing public and stating that "prospective remedies whose purpose is to protect the investing public from future harm" do not implicate retroactivity concerns).

60 *Landgraf*, 511 U.S. at 270 n.24.

61 *See supra* notes 9-10 and accompanying text.

62 *See Boniface v. Dep't of Homeland Sec.*, 613 F.3d 282, 288 (D.C. Cir. 2010) (holding that denial of future occupational opportunities based on thirty-year-old conviction for transporting hazardous materials did not trigger any of the effects deemed retroactive in Landgraf and thus conviction could be considered as evidence of future risk), *cert. denied*, 131 S. Ct. 931 (2011); *see also Ohio Head Start Ass'n v. Dep't of Health and Human Services*, 873 F. Supp. 2d 335, 247-48 (D.D.C. 2012) (discussing U.S. Supreme Court precedent and concluding that the principal focus for determining whether to allow "regulations [to] use antecedent information in making future decisions lies in the notion of imposing a 'liability' versus denying an individual a 'future benefit'") (citations omitted), *aff'd*, 510 F. App'x 1 (D.C. Cir. 2013) (per curiam) (unpublished).

63 *Boniface*, 613 F.3d at 288.

that denial was triggered by a 1975 conviction that predated the 2003 adoption of the regulations governing the HME application process, the court stated that the disqualifying conviction created only an evidentiary presumption. That presumption was provisional and could be rebutted by seeking a waiver from TSA and showing that an HME would pose no current threat.[64] Therefore, the court found that applying the regulations to Boniface did not have an impermissible retroactive effect. Quoting *Landgraf*, the court stated that the regulatory scheme did not impair rights that Boniface possessed when he acted, increase his liability for past conduct, or impose new duties on transactions already completed.

Like the driver's 1975 conviction in *Boniface*, Savva's Vermont Order was the antecedent event that subjected him to statutory disqualification, but, similar to the proceedings in *Boniface*, Savva and his firm could seek relief from the statutory disqualification through the MC-400 Application process, during which they had the opportunity to demonstrate that Savva's continued participation in the securities industry did not pose a current threat to investors. The application of the 2009 eligibility procedures to Savva did not impair rights that he possessed at the time of the 2004 Vermont Order, increase his liability for the conduct that was the basis of the Vermont Order, or impose new duties for transactions already completed.

Second, an inquiry into retroactivity is often informed and guided by "familiar considerations of fair notice, reasonable reliance, and settled expectations,"[65] and those considerations do not support Hunter Scott's and Savva's retroactivity argument. Since 2002, when the Sarbanes-Oxley Act amended the Exchange Act, Hunter Scott and Savva have had fair notice that a "final order," including a final order issued by a state securities regulator, would constitute a disqualifying event for purposes of eligibility to participate in the securities industry. Indeed, in early 2003, FINRA notified members that it proposed to amend the definition of "disqualification" in its By-Laws to be consistent with the Exchange Act's definition and incorporate the additional categories of statutory disqualification enacted in the Sarbanes-Oxley Act.[66] That same year, the Commission approved amendments to FINRA's uniform registration forms to require reporting of the additional disqualifying events created by the Sarbanes-Oxley Act, including a definition of "final order" that would encompass the 2004 Vermont Order.[67]

Although FINRA did not have the necessary rules and procedures in place until 2009 for those persons subject to disqualification as a result of the Sarbanes-Oxley Act, FINRA's application of the amended eligibility procedures to Hunter Scott and Savva could not have undermined their reasonable reliance interests or settled expectations. Historically, FINRA's rules had required persons subject to then-existing statutory disqualifications to apply for relief from the disqualifications. Thus, Savva cannot reasonably rely on the fact that there was a lag between the time the Exchange Act's definition of statutory disqualification was amended in

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64 *Id.*

65 *Landgraf*, 511 U.S. at 270.

66 FINRA Notice to Members 03-04 (January 2003), *available at* http://www.finra.org/Industry/Regulation/Notices/2003/P003363.

67 *See supra* note 39.

2002 and FINRA's conforming amendments. Furthermore, industry participation is a privilege, not a right, and Savva had no vested right in future association with Hunter Scott.[68]

2. Hunter Scott and Savva had fair notice of the basis for disqualification.

Hunter Scott and Savva argue that they did not have fair notice of the basis for Savva's statutory disqualification. FINRA Rule 9522(a) provides that if FINRA has reason to believe that an associated person is statutorily disqualified, it "shall specify the grounds for such disqualification or ineligibility" in a written notice to the member.[69] FINRA's RAD issued such a notice on June 15, 2009, informing Hunter Scott that Savva was subject to a statutory disqualification under Exchange Act Section 3(a)(39) because of the Vermont Order. Thus, Hunter Scott and Savva have known since at least June 2009 that the Vermont Order was the basis for FINRA's determination that Savva was subject to disqualification. FINRA properly satisfied the notice requirements of FINRA Rule 9522(a).

Hunter Scott and Savva argue that after the June 2009 notice, Member Regulation had asserted, as the sole basis for disqualification, that the Vermont order was disqualifying because it was a final order barring Savva. They argue that until the Hearing Panel ordered the parties to brief the precise grounds for disqualification, Member Regulation had not asserted that the Vermont Order was also disqualifying because it was based on laws or regulations prohibiting fraudulent, manipulative, or deceptive conduct, and that it was unfair for Member Regulation to assert this additional reason why the Vermont order was disqualifying.

As an initial matter, Hunter Scott and Savva, who at all times were represented by counsel, had ample notice and opportunity throughout the proceedings to address and argue the legal issue of whether the Vermont Order was disqualifying under Exchange Act Section 15(b)(4)(H)(i) and/or (ii). Several months before the November 2011 hearing, the Hearing Panel requested the parties to brief whether Savva was disqualified because he was subject to a final order barring him from association with a broker-dealer, or because he was subject to a final order based on violations of laws or regulations that prohibit fraudulent, manipulative, or deceptive misconduct. The Hearing Panel made this request because, after its preliminary review of the record, the exact basis for disqualification was unclear. The parties each filed briefs on the issue, and Member Regulation argued that the Vermont Order was disqualifying under both Exchange Act Sections 15(b)(4)(H)(i) and (ii). FINRA ultimately did not reach the issue of whether the Vermont Order was disqualifying under Exchange Act Section 15(b)(4)(H)(i) because it found that the Vermont Order was disqualifying under Exchange Act

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[68] *Cf. Kornman v. SEC*, 592 F.3d 173, 188 (D.C. Cir. 2010) (describing industry participation as "'a privilege voluntarily granted" rather than a right) (quoting *Hudson v. United States*, 522 U.S. 93, 104 (1997)); *Gregory Bartko*, Exchange Act Release No. 71666, 2014 WL 896758, at *13 (Mar. 7, 2014) (imposing collateral bar on respondent in follow-on administrative proceeding, and stating that respondent, was not then associated with municipal advisors or nationally recognized statistical rating organizations, did not have a "vested right" to any such future association), *appeal filed* No. 14-1070 (D.C. Cir. May 6, 2014).

[69] FINRA Rule 9522(a).

Section 15(b)(4)(H)(ii). Consequently, Hunter Scott and Savva cannot establish that they lacked fair notice of the basis for Savva's statutory disqualification.[70]

3. FINRA properly admitted a post-hearing exhibit.

Hunter Scott and Savva argue that FINRA unfairly based its denial of the MC-400 Application on a transcript of the Vermont securities regulators' October 2003 sworn investigative interview of Savva. Hunter Scott and Savva contend that, because FINRA admitted the transcript into evidence after the November 2011 hearing, they had no opportunity to explain Savva's testimony at the hearing. We disagree and conclude that FINRA properly admitted the transcript.

The record shows that approximately one month after the hearing, Member Regulation filed a motion seeking to introduce the transcript of Savva's October 2003 sworn investigative interview in which he testified before Vermont securities regulators that he spoke to a customer and recommended the securities at issue in the Vermont Order. Member Regulation sought to introduce the transcript of the October 2003 investigative interview to rebut Savva's testimony at the hearing that he merely filled out the customer's order ticket and had no further involvement with the customer. Savva objected to Member Regulation's motion, arguing that introduction of the transcript would create the potential for serious prejudice and that Member Regulation should not be allowed to "reopen" the record following the hearing. After affording Hunter Scott and Savva an opportunity to respond to Member Regulation's motion and after receiving pleadings in response, the NAC admitted the transcript into evidence "solely for the purpose of considering Savva's differing explanations of the events surrounding the Vermont Order."

FINRA's rules confer upon an adjudicator the authority to decide procedural matters in FINRA eligibility proceedings and do not require the adjudicator to apply the formal rules of evidence operative in the federal courts.[71] We find that FINRA acted properly under its rules

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[70] In addition, the NAC was not bound by Member Regulation's characterization of the alleged basis for Savva's statutory disqualification. The NAC, as an adjudicator, was free to raise and address this legal issue sua sponte. *See, e.g.*, *Henderson v. Dep't of Interior*, 202 F.3d 1356, 1360 (Fed. Cir. 2000) (an adjudicator is free to address sua sponte legal issues that neither party raised) (citing *Special Counsel v. Filiberti*, 27 M.S.P.R. 498, 504 (1984), *affirmed in part and remanded in part,* 804 F.2d 1504 (9th Cir. 1986)). To promote FINRA's mission to protect public investors, the NAC may independently determine whether a person is statutorily disqualified under the Exchange Act on grounds other than those urged by the parties. *See, e.g.*, *FCS Sec.*, Exchange Act Release No. 64852, 2011 WL 2680699, at *7 (July 11, 2011) (holding that the Commission was not bound by statements of its staff) & n.27 (collecting cases); *JJFN Serv., Inc.*, Exchange Act Release No. 39343, 53 SEC 335, 1997 WL 722029, at *4 (Nov. 21, 1997) (holding that statements made by Nasdaq staff with respect to an application for listing on the automatic quotation system did not bind NASD).

[71] *See* FINRA Rules 9146(j)(3) ("In the Rule 9500 Series, a motion shall be decided by an Adjudicator, except that a procedural motion made pursuant to the Rule 9520 Series or Rule

(continued...)

when it admitted the transcript of Savva's October 2003 investigative interview for the limited purpose of evaluating his credibility.[72] The NAC's use of the transcript for this limited purpose had no impact on the fact that the Vermont Order was a disqualifying event, that it involved serious, securities-related misconduct, that Savva was the subject of at least ten customer complaints and two regulatory matters, that Hunter Scott's proposed plan of supervision was inadequate, and that the Firm failed to establish its ability to comply with the plan.

4. Hunter Scott and Savva were not prejudiced by the passage of time.

Hunter Scott and Savva argue that they were unfairly prejudiced by the five-year delay between the Vermont Department's entry of its order in August 2004 and FINRA's notice in June 2009 that Savva was subject to a statutory disqualification, and that they were further prejudiced by the additional three years until FINRA denied Hunter Scott's MC-400 Application in August 2012. They cite to *Jeffrey Ainley Hayden*[73] for the proposition that the asserted delays "expose[] the inherent unfairness of these proceedings."

In *Hayden*, the Commission set aside a disciplinary proceeding by the New York Stock Exchange that resulted in findings that Hayden engaged in misconduct by, among other things, making unsuitable recommendations and making material misrepresentations and omissions. The Commission found that the delay in bringing the underlying disciplinary proceeding against Hayden—approximately fourteen years from the time of the first act of misconduct to the filing of charges against Hayden and more than six years from the last act—violated the Exchange Act's fairness requirements.

Hunter Scott and Savva have not shown how any of the asserted delays rendered the proceeding unfair. Moreover, since *Hayden*, we have made it clear that even in disciplinary proceedings, there are no "bright line rules" or "mechanical tests" to determine whether a delay is unfair; rather, fairness is determined by examining the entire record.[74] We have conducted an independent review of the record and find no unfairness as a result of the asserted delays.

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9559(q)(3) may be decided by Counsel to the National Adjudicatory Council.") & 9145(a) ("The formal rules of evidence shall not apply in a proceeding brought under the Rule 9000 Series.").

72 *See, e.g.*, *Boleslaw Wolny*, Exchange Act Release No. 40013, 53 SEC 590, 1998 WL 254806, at *2 (May 20, 1998) (holding that FINRA correctly adhered to its long-standing policy of prohibiting collateral attacks on underlying disqualifying events). Furthermore, Hunter Scott and Savva's argument that the hearing had been "closed," and therefore the Hearing Panel could not admit any additional evidence, runs contrary to FINRA rules, which provide that the Hearing Panel may order the parties to supplement the record "at any time prior to the issuance of its recommendation." FINRA Rule 9524(a)(3)(C).

73 Exchange Act Release No. 42772, 54 SEC 651, 2000 WL 649146 (May 11, 2000).

74 *Mark H. Love*, Exchange Act Release No. 49248, 57 SEC 315, 2004 WL 283437, at *4 (Feb. 13, 2004).

D. FINRA rules are, and were applied in a manner, consistent with the Exchange Act.

We last turn to whether FINRA's rules are, and were applied in a manner, consistent with the Exchange Act.[75] FINRA may deny a firm's application for continued association with a statutorily disqualified person if FINRA determines that such association would be inconsistent with the public interest and protection of investors.[76] To this end, FINRA must "'independently [evaluate the] application, based upon the totality of the circumstances, and . . . explain the bases for its conclusion.'"[77] In doing so, FINRA "may demand a high level of integrity from securities professionals" to protect the investing public.[78] We also have recognized that FINRA has discretion in determining whether persons subject to disqualification should be permitted to associate with a member.[79] Moreover, in a FINRA proceeding such as this one, "the burden rests on the applicant to show that, despite the disqualification, it is in the public interest to permit the requested employment."[80] Here, we find that FINRA acted in a manner consistent with the Exchange Act when it considered the allegations underlying the Vermont Order, Savva's history

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[75] We previously found that FINRA's By-Law definition of disqualification "is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities association." Exchange Act Release No. 56145, 2007 WL 5185330, at *19 (July 26, 2007). In particular, we found the definition of disqualification in FINRA's By-Laws to be "consistent with Section 15A(b)(6) of the Exchange Act, in that it is designed, among other things, to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest." *Id.* We made similar findings in approving the amendments to FINRA's eligibility rules. *See* Exchange Act Release No. 59586, 2009 WL 763690, at *3 (Mar. 17, 2009).

[76] *See* 15 U.S.C. § 78o-3(g)(2); *see generally Frank Kufrovich,* Exchange Act Release No. 45437, 55 SEC 616, 2002 WL 215446, at *4 (Feb. 13, 2002) (describing the steps that FINRA, then NASD, must take when denying an application to be consistent with the purposes of the Exchange Act).

[77] *Arouh*, 2010 WL 3554584, at *12 (quoting *Timothy P. Pedregon*, Exchange Act Release No. 61791, 2010 WL 1143089, at *5 (Mar. 26, 2010)).

[78] *Id.* at *13 (quoting *Kufrovich*, 2002 WL 215446, at *5).

[79] *See, e.g.*, *Arouh*, 2010 WL 3554584, at *13 (stating that the Commission has "afforded FINRA discretion in determining whether persons subject to statutory disqualification should be permitted to associate with a member firm"); *Am. Inv. Servs., Inc.*, Exchange Act Release No. 43991, 54 SEC 1265, 2001 WL 167861, at *3 (Feb. 21, 2001) ("NASD is afforded discretion in considering the circumstances under which a person subject to a statutory disqualification may associate with a member."); *Halpert & Co.,* Exchange Act Release No. 28615, 50 SEC 420, 1990 WL 322213, at *3 (Nov. 14, 1990) ("Particularly in matters involving a firm's employment of persons subject to a statutory disqualification, it is appropriate to recognize the NASD's evaluation of appropriate business standards for its members.").

[80] *Emerson*, 2009 WL 2138439, at *4 (quoting *Gershon Tannenbaum*, Exchange Act Release No. 31080, 50 SEC 1138, 1992 WL 213844, at *2 (Aug. 24, 1992)).

of customer complaints and regulatory matters, and Hunter Scott's proposed supervisory plan, and concluded that Hunter Scott did not meet its burden of showing that it would be in the public interest for Savva to continue associating with the Firm.

FINRA properly considered that the Vermont Order stemmed from allegations of serious, securities-related misconduct. We have repeatedly stated that "[u]nauthorized trading is very serious misconduct,"[81] emphasized the importance of ensuring that recommended securities are suitable for customers,[82] and condemned the use of high-pressure sales tactics.[83] We agree with FINRA that the seriousness of Savva's conduct weighed against allowing the Application.

We also agree with FINRA that Savva's history of at least ten customer complaints and two regulatory matters raised serious concerns about Savva's dealings with customers and his ability to comply with securities laws and regulations.[84] Hunter Scott and Savva argue that the customer complaints are stale and that FINRA based its denial on events that happened nearly a decade ago. But their argument overlooks that at least three customer complaints were filed against Savva between 2007 and 2008, and that in April 2009, Savva received a Cautionary Action from FINRA for, among other things, making unsuitable recommendations and engaging in excessive trading. In any event, FINRA appropriately reviewed and considered Savva's entire regulatory history in determining that Savva's continued association with Hunter Scott would present an unreasonable risk of future harm to the market or investors.[85]

Hunter Scott and Savva fault FINRA for assigning little or no weight to Savva's "recent, positive track record, including the fact that he has not had a single customer complaint during the last four years." In support, they attach to their opening brief eleven affidavits from customers that purportedly demonstrate their satisfaction with Savva and his "current business practices."[86] Hunter Scott and Savva did not, however, attempt to offer these affidavits during

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81 *Wanda P. Sears*, Exchange Act Release No. 58075, 2008 WL 2597567, at *6 & n.32 (July 1, 2008) (quoting *Howard Alweil*, Exchange Act Release No. 31278, 51 SEC 14, 1992 WL 288827, at *4 (Oct. 1, 1992)).

82 *See, e.g., Weiss*, 2013 WL 1122496, at *7.

83 *See, e.g., Bugarski*, 2012 WL 1377357, at *2 n.8 (collecting cases).

84 *See Emerson*, 2009 WL 2138439, at *5 (holding that FINRA reasonably concluded that two customer complaints filed against disqualified individual and settled by his firm, as well as discharges from prior firms, reflected poorly on his judgment and trustworthiness); *Kufrovich*, 2002 WL 215446, at *2 (holding it is appropriate to consider individual's prior disciplinary history).

85 *See Emerson*, 2009 WL 2138439, at *5 (stating that "[e]ven where prior misconduct is not recent, it still reflects poorly on [an applicant's] judgment and trustworthiness") (quoting *Kufrovich*, 2002 WL 215446, at *6).

86 All eleven affidavits were submitted for the first time on appeal as an attachment to Hunter Scott's and Savva's unsuccessful stay motion. Each affidavit generally contains similar language regarding the customer's interactions with Savva, his purported expertise, and each

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the FINRA process, so FINRA cannot be faulted for disregarding documents that it never had the opportunity to consider. Under the Commission's Rule of Practice 452, a party who wishes to introduce additional evidence must file a motion for leave to do so.[87] This rule requires the motion to "show with particularity that such additional evidence is material and that there were reasonable grounds for failing to adduce such evidence previously."[88] Hunter Scott and Savva meet none of these standards. They did not file a motion seeking permission to introduce the new evidence; they have not explained with particularity why they did not introduce the evidence during the FINRA proceeding; and none of the affidavits deals with the relevant issues here. The letters purport to show that eleven customers were satisfied with Savva's services but do not address the specific circumstances surrounding the Vermont Order or the ten customer complaints and two regulatory matters—circumstances that FINRA reasonably concluded raised serious concerns about Savva's dealings with customers and compliance with securities laws and regulations. We therefore decline to admit this evidence.[89]

Hunter Scott and Savva further argue that permitting Savva to continue his employment with the Firm will serve the public interest because Savva's customers have relied on his expertise in connection with their investment decisions and his disqualification will deprive them of their "right" to choose their own broker. They also argue that FINRA's denial "effectively prevents Mr. Savva from exercising his fundamental right to earn a livelihood and thus merits exceptionally close scrutiny by the Commission." We have rejected similar arguments in other cases and do so again here. Savva has "no absolute right" to engage employment in the

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(...continued)
customer's belief that Savva would not cause any harm if permitted to continue to associate with Hunter Scott.

87 17 C.F.R. § 201.452.

88 *Id.*; *see also* 17 C.F.R. § 201.460(c) (providing that documents not admitted at the hearing "shall not be considered a part of the record before the Commission").

89 *See Weiss*, 2013 WL 1122496, at *8-9 (declining to admit evidence where applicant had not sought permission to do so, had not explained why he did not introduce the evidence previously, and none of the letters from former and current customers addressed the relevant issues in the case); *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 WL 5462896, at *13 (Nov. 9, 2012) (declining to admit evidence where applicant had not sought permission to do so, had not explained failure to introduce exhibits earlier, and attachments did not address issues relevant to the case); *John Edward Mullins*, Exchange Act Release No. 66373, 2012 WL 423413, at *14 n.60 (Feb. 10, 2012) (declining to admit exhibits attached to an applicant's brief that were "not material to [the applicant's] case" and addressed issues not under review); *CMG Inst. Trading, LLC*, Exchange Act Release No. 59325, 2009 WL 223617, at *6 & n.20 (Jan. 30, 2009) (determining not to admit documents when applicants did not file a motion under Rule 452).

securities industry.[90] His customers "remain free to find another [broker]. The Commission has an obligation to protect the investing public."[91]

Finally, FINRA considered Hunter Scott's proposed supervisory plan and properly found that its design and implementation were flawed. In assessing a supervisory plan, "we require . . . stringent supervision for a person subject to a statutory disqualification."[92] FINRA found that Hunter Scott's proposed supervisory plan was "skeletal, lack[ed] specificity, and [was] not specifically tailored to Savva and preventing misconduct similar to the Vermont Order." We agree and conclude that the proposed plan did not contain provisions sufficient to ensure that Hunter Scott properly supervised Savva. For instance, the plan could have, but did not, set forth procedures for reviewing or monitoring Savva's communications with customers, did not contain procedures for handling any future customer complaints filed against Savva, and did not designate a backup supervisor for Savva.[93] The plan also proposed a replacement supervisor, Hunter Scott's CCO, who, as recently as 2008, was the subject of customer complaints alleging excessive and unsuitable trading and churning.[94]

Equally troubling was Hunter Scott's implementation of the heightened supervisory procedures that had been in place since March 2004.[95] Four customer complaints and two regulatory matters arose while Savva was subject to the enhanced supervisory plan. The fact that

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[90] *Walter H. T. Seager*, Exchange Act Release No. 20831, 47 SEC 1040, 1984 WL 589596, at *2 (Apr. 6, 1984) (stating that respondent had "no absolute right" to engage in the securities business).

[91] *Christopher A. Lowry*, Investment Advisers Act Release No. 2052, 55 SEC 1133, 2002 WL 1997959, at * 6 (Aug. 30, 2002), *aff'd*, 340 F.3d 501 (8th Cir. 2003).

[92] *William J. Haberman*, Exchange Act Release No. 40673, 53 SEC 1024, 1998 WL 786945, at *4 (Nov. 12, 1998).

[93] *See Morton Kantrowitz*, Exchange Act Release No. 44239, 55 SEC 98, 2001 WL 435668, at *5 (May 1, 2001) (stating that, "[i]n determining whether to permit the employment of a statutorily disqualified person, the quality of the supervision to be accorded that person is of the utmost importance. We have made it clear that such persons must be subject to stringent oversight by supervisors who are fully qualified to implement the necessary controls.") (footnote omitted); *cf. NASD Regulatory and Compliance Alert* (Winter 1999), at 17-18 (stating that, although there is no one plan appropriate for each disqualified individual, most plans should contain certain features, including provisions concerning reporting and handling customer complaints), *available at* http://www.finra.org/web/groups/ industry/@ip/@reg/@guide/documents/rca/p002379.pdf.

[94] According to the CRD, the CCO has been registered with Hunter Scott since March 2006 and was the subject of two customer complaints, one in April 2007 alleging that he engaged in excessive and unsuitable trading, and the other in July 2008 alleging that he churned accounts and charged excessive fees and commissions. Hunter Scott settled both matters for a total of $187,500, without Hughes personally contributing to the settlements.

[95] *See supra* note 18.

Savva may not have received a customer complaint since Hunter Scott filed its MC-400 Application with FINRA's RAD in 2009 does not erase his poor track record from 2004 to 2009. We also consider that, in April 2009, Hunter Scott received a Cautionary Action from FINRA for failing to follow its supervisory plan for Savva.[96]

As FINRA found, Hunter Scott's proposed plan does not reflect the careful consideration required to effectively supervise a statutory disqualified individual and lacks specifically tailored provisions designed to prevent and deter future misconduct.[97] Hunter Scott's proposed plan consists merely of four general provisions beyond the supervision to which all Hunter Scott registered representatives are subject. The plan is not sufficiently tailored to address Savva's past misconduct or prevent similar conduct in the future. The lack of details and controls in the plan is particularly troubling considering that the events that led to the Vermont Order occurred while Savva was on heightened supervision at his prior firm, J.P.Turner.

Hunter Scott and Savva argue that FINRA "failed to give appropriate consideration to an amended and strengthened supervision plan that was provided to FINRA in advance of its determination." But the only difference between the firm's original heightened supervisory plan and its amended plan is that Hunter Scott's CCO would serve as Savva's primary supervisor instead of the firm's Brooklyn office manager and that Savva would work in the Delray Beach office instead of the Brooklyn office. FINRA considered these facts and determined that it did not matter who supervised Savva because the proposed plan itself was inherently flawed.

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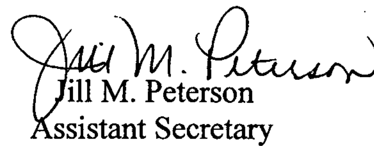
96 *See, e.g.*, *Emerson*, 2009 WL 2009 WL 2138439, at *6 (considering a firm's prior violation of its own rules regarding heightened supervision in denying application); *Kantrowitz*, 2006 WL 2252394, at *5 (stating that "[t]he firm's recent regulatory violations, when considered with the disciplinary sanctions imposed against it . . . , suggest that the Firm has continuing difficulties with strict compliance with its regulatory obligations, raising doubts as to the Firm'[s ability to provide the supervision required to ensure that [Applicant] does not engage in future violative conduct.").

97 *See, e.g.*, *Arouh*, 2010 WL 3554584, at *10 (finding inadequate proposed plan of supervision where much of the plan applies to all firm employees). Although counsel for Savva and Hunter Scott represented that the Firm would incorporate into the heightened supervisory plan any other terms necessary for the application to be approved, it was the Firm's burden in the first instance to draft and propose a supervisory plan that provides for stringent supervision. *See, e.g.*, *Pedregon*, 2010 WL 1143089, at *6 & n.32 (holding that FINRA was fully justified in requiring a firm to provide specifics before approving an application rather than accepting assurances that the firm would later devise an appropriate plan); *Emerson*, 2009 WL 2138439, at *6 (holding that drafting a supervisory plan is the firm's responsibility, not FINRA's).

III. Conclusion

For the foregoing reasons, we have determined to dismiss Hunter Scott's and Savva's appeal. An appropriate order will issue.[98]

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN; Commissioners GALLAGHER and PIWOWAR concur in the judgment, but base their determination that FINRA's application of its rules was not impermissibly retroactive solely on the ground that Respondents had fair notice of the statutory disqualification).



Jill M. Peterson
Assistant Secretary

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72485 / June 26, 2014

Admin. Proc. File No. 3-15017

In the Matter of the Application of

NICHOLAS S. SAVVA and HUNTER SCOTT
FINANCIAL, LLC
c/o Michael Schwartzberg, Esq.
Winget, Spadafora & Schwartzberg, LLP
45 Broadway, 19th Floor
New York, New York 10006

For Review of Action Taken by
FINRA

ORDER DISMISSING REVIEW PROCEEDINGS

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

ORDERED that the application for review filed by Nicholas S. Savva and Hunter Scott Financial, LLC is hereby dismissed.

By the Commission.

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. 72481 / June 26, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15949

In the Matter of **ANTHONY M. LIVOTI, JR.** **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 Anthony M. Livoti, Jr. pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. 200.102(e)(2)].[1]

II.

The Commission finds that:

1. Livoti is an attorney, whom the State of Florida admitted to practice law in 1974.

2. On December 4, 2013, a judgment of conviction was entered against Livoti in the criminal case entitled U.S. v. Livoti, Case No. 08-21158-CR-SCOLA (S.D. Fla. Dec. 23, 2008), in the United States District Court for the Southern District of Florida, finding him guilty of one count of Conspiracy to Commit Mail and Wire Fraud in violation of 18 U.S.C.§1349; two counts of Mail Fraud in violation of 18 U.S.C. §§1341 and 1342; and one count of Conspiracy to Commit Money Laundering in violation of 18 U.S.C.§1956(h). Livoti's conduct was in connection with his role as the independent premium trustee of investor funds for Mutual Benefits Corp., a defunct viatical services provider formerly located in Fort Lauderdale, Florida.

[1] Rule 102(e)(2) provides in pertinent part: "Any attorney who has been suspended or disbarred by a court of the United States or of any State ... or any person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

3. As a result of this conviction, on April 1, 2014, Livoti was sentenced to 10 years imprisonment in a federal penitentiary, 3 years supervised release, and ordered to pay restitution in the amount of $826,839,642.

4. In a separate proceeding, on January 14, 2014, the Florida Supreme Court suspended Livoti from the practice of law in the matter The Florida Bar v. Anthony Martin Livoti, Jr., Case No. SC14-13 (Jan. 14, 2014). The court based its ruling on a Notice of Determination or Judgment of Guilt by the Florida Bar which found that Livoti engaged in violations of the Rules Regulating the Florida Bar based on his conviction.

III.

In view of the foregoing, the Commission finds that Livoti is an attorney who has been convicted of a felony and been suspended from the practice of law within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED, that Anthony M. Livoti, Jr. 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
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3864 / June 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15950

In the Matter of S.A.C. CAPITAL ADVISORS, L.P. S.A.C. CAPITAL ADVISORS, LLC CR INTRINSIC INVESTORS, LLC SIGMA CAPITAL MANAGEMENT, LLC PARAMETER CAPITAL MANAGEMENT, LLC 72 CREDIT MANAGEMENT, LLC S.A.C. PRIVATE EQUITY GP, L.P. POINT72 ASIA (HONG KONG) LIMITED POINT72 ASIA (NORTH ASIA) LIMITED and POINT72 ASIA (SINGAPORE) PTE. LTD Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(e) of the Investment Advisers Act of 1940 (the "Advisers Act") against S.A.C. Capital Advisors, L.P. ("SAC LP"), S.A.C. Capital Advisors, LLC ("SAC LLC"), CR Intrinsic Investors, LLC ("CR Intrinsic"), Sigma Capital Management, LLC ("Sigma Capital"), Parameter Capital Management, LLC ("Parameter"), 72 Credit Management, LLC ("72 Credit"), S.A.C. Private Equity GP, L.P. ("SAC Private Equity"), Point72 Asia (Hong Kong) Limited f/k/a S.A.C. Capital Advisors (Hong Kong) Limited) ("SAC Hong Kong"), Point72 Asia (North Asia) Limited (f/k/a S.A.C. Capital Advisors (North Asia) Limited) ("SAC North Asia"), Point72 Asia (Singapore) Pte. Ltd. (f/k/a S.C. Advisors (Singapore) Pte. Ltd.) ("SAC Singapore," and collectively with SAC LP, SAC LLC, Sigma Capital, CR Intrinsic, Parameter, 72 Credit, SAC Private Equity, SAC Hong Kong, and SAC North Asia, "the SAC Entities" or "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondents consent to the Commission's jurisdiction over them and the subject matter of these proceedings, and the findings contained in Section III.C. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

A. RESPONDENTS

1. SAC LP is a Stamford, Connecticut-based investment adviser that has been registered with the Commission since March 2012. Steven A. Cohen ("Cohen") is the Chief Executive Officer of SAC LP and indirectly owns more than 99.9% of the firm. SAC LP, along with certain of the other SAC Entities, advises multiple hedge funds and, as of February 1, 2014, managed approximately $11.9 billion in net assets. Of that amount, approximately $623 million, as of February 1, 2014, was attributable to "side pocket" investments that are not available for redemption.

2. SAC LLC is an entity based in Stamford, Connecticut and affiliated with Cohen that managed certain affiliated hedge funds until the end of 2008, when SAC LP became the investment adviser to such funds.

3. CR Intrinsic is an entity located in Stamford, Connecticut that is a wholly-owned subsidiary of SAC LP and was registered with the Commission in reliance on the registration of SAC LP as an investment adviser from March 2012 until April 11, 2014. On November 20, 2012, the Commission charged CR Intrinsic with insider trading in SEC v. CR Intrinsic Investors, LLC, et al., 12-CV-8466 (VM) (S.D.N.Y.). On April 15, 2013, the U.S. District Court for the Southern District of New York conditionally approved the Commission's settlement with CR Intrinsic, which included a permanent antifraud injunction and required the firm to pay $274,972,541 in disgorgement, $51,802,381.22 in prejudgment interest, and a $274,972,541 penalty.

4. Sigma Capital is an entity located in New York, New York that is a wholly-owned subsidiary of SAC LP and was registered with the Commission in reliance on the registration of SAC LP as an investment adviser from March 2012 until April 11, 2014. On March 15, 2013, the Commission filed SEC v. Sigma Capital Management, LLC, et al., 13-CV-1740 (HB) (S.D.N.Y.), a settled insider trading action against Sigma Capital (which also named two hedge funds managed by Sigma Capital and SAC LP as relief defendants). On March 28, 2013, the Court approved the Commission's settlement with Sigma Capital, which included a

permanent antifraud injunction and required the firm to pay disgorgement of $6.425 million, prejudgment interest of $1,094,161.92, and a civil penalty of $6.425 million.

5. Parameter is an entity located in Stamford, Connecticut that is a wholly-owned subsidiary of Point72 Asset Management, L.P., a Delaware limited partnership ("Point72"), and was registered with the Commission in reliance on the registration of SAC LP as an investment adviser from March 2012 until April 11, 2014.

6. 72 Credit is an investment adviser located in Stamford, Connecticut that is a wholly-owned subsidiary of SAC LP and is registered with the Commission in reliance on the registration of SAC LP as an investment adviser. 72 Credit manages fixed income investments, including several side pocket investments.

7. SAC Private Equity is an entity located in Stamford, Connecticut that is under common control with SAC LP and in reliance on the registration of SAC LP as an investment adviser from March 2012 until April 11, 2014.

8. SAC Hong Kong is an entity located in Hong Kong, China that is under common control with SAC LP and was registered with the Commission in reliance on the registration of SAC LP as an investment adviser from March 2012 until April 11, 2014.

9. SAC North Asia is an entity located in Japan that is a wholly-owned subsidiary of SAC Hong Kong and was registered with the Commission in reliance on the registration of SAC LP as an investment adviser from March 2012 until April 11, 2014.

10. SAC Singapore is an entity located in Singapore that is under common control with SAC LP and was registered with the Commission in reliance on the registration of SAC LP as an investment adviser from March 2012 until April 11, 2014.

B. RELATED PERSON

11. Cohen, age 58, resides in Greenwich, Connecticut. He is the founder and owner of various investment advisers under the moniker S.A.C., including SAC LP. Prior to entering the hedge fund advisory business in 1992, Cohen held a Series 3 license while employed at Gruntal & Co. On July 19, 2013, the Commission instituted administrative proceedings against Cohen pursuant to Section 203(f) of the Advisers Act based on allegations by the Commission's Division of Enforcement that Cohen failed reasonably to supervise his employees with a view to preventing them from engaging in insider trading in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. On August 8, 2013, Chief Administrative Law Judge Brenda Murray granted an application by the United States Attorney's Office for the Southern District of New York ("USAO") to intervene in the administrative proceedings against Cohen and ordered the proceedings stayed pending the resolution of the parallel criminal cases against Mathew Martoma (a former portfolio manager at CR Intrinsic), Michael Steinberg (a former portfolio manager at Sigma Capital), and SAC LP, SAC LLC, CR Intrinsic, and Sigma Capital.

C. THE CRIMINAL CONVICTIONS AGAINST SAC LP, SAC LLC, SIGMA CAPITAL, AND CR INTRINSIC

12. On July 23, 2013, SAC LP, SAC LLC, CR Intrinsic, and Sigma Capital were each charged with one count of wire fraud in violation of 18 U.S.C. § 1343, and one count of securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff and 17 C.F.R. §§ 240.10b-5 and 240.10b5-2. On the same date, the USAO also filed a civil forfeiture action, entitled U.S. v. S.A.C. Capital Advisors L.P., et al., 13-CV-5182 (RJS) (S.D.N.Y.), against SAC LP, SAC LLC, CR Intrinsic, Sigma Capital and 24 investment funds managed by SAC LP and/or its investment adviser subsidiaries (as in rem defendants).

13. On November 8, 2013, SAC LP, SAC LLC, CR Intrinsic, and Sigma Capital each pleaded guilty to one count of wire fraud and securities fraud pursuant to a plea agreement with the USAO. The plea agreement requires the four defendants to pay a criminal fine totaling $900 million. In addition, the agreement requires the four defendants to forfeit an additional $900 million in the civil forfeiture action, although the forfeiture amount was reduced by $616 million in light of the amounts that that CR Intrinsic and Sigma Capital had already paid or agreed to pay to settle insider trading charges brought by the Commission in SEC v. CR Intrinsic Investors, LLC, et al., 12-CV-8466 (VM) (S.D.N.Y.) and SEC v. Sigma Capital Management, LLC, et al., 13-CV-1740 (HB) (S.D.N.Y.). The guilty pleas by SAC LP, SAC LLC, CR Intrinsic, and Sigma Capital were accepted by the court on April 10, 2014.

14. The criminal charges against SAC LP, SAC LLC, CR Intrinsic and Sigma Capital alleged, among other things, that multiple employees and agents of those entities, over the course of several years, obtained material, nonpublic information relating to publicly-traded companies and executed, or caused the funds managed by those entities to execute, securities trades based on that information.

Undertakings

15. As part of the Offer of Settlement, Respondents undertake:

a. before June 30, 2014, to transfer to a family office established by Cohen in accordance with Advisers Act Rule 202(a)(11)(G)-1 the management of the investments in the private funds managed by the SAC Entities that are currently held by Cohen and/or persons or entities eligible to be clients of a family office operated by Cohen;

b. before June 30, 2014, that SAC LLC, Sigma Capital, CR Intrinsic, Parameter, SAC Private Equity, SAC Hong Kong, SAC North Asia, and SAC Singapore will cease to be "investment advisers," as defined under Section 202(a)(11) of the Advisers Act;

c. before June 30, 2014, SAC LP and 72 Credit will cease to be "investment advisers," as defined under Section 202(a)(11) of the Advisers Act, except

with respect to the side pocket investments and related investments listed in Appendix A to the Offer of Settlement;

d. before June 30, 2014, to discontinue the substantive involvement of Cohen in the management by SAC LP and 72 Credit of investments, and, to the extent that Cohen's participation in a given investment is solely due to a direct or indirect investment by Cohen in one or more funds managed by SAC LP or 72 Credit, cease to provide Cohen with any information about such investments that is not simultaneously provided to third-party investors in funds managed by SAC LP or 72 Credit who are participants in such investments;

e. before December 31, 2015, to distribute to the Cohen family office, funds managed by the Cohen family office and/or third-party investors all side pocket investments listed in Appendix A to the Offer of Settlement, proceeds from the liquidation thereof and/or ownership interests in an entity holding all or a portion of such investments, and for SAC LP and 72 Credit to cease to be "investment advisers," as defined under Section 202(a)(11) of the Advisers Act, with the understanding that SAC LP and/or 72 Credit may, in order to allow them to complete an orderly wind-down of their business as registered investment advisers, apply to the Commission to extend the date by which they must distribute the side pocket investments, proceeds therefrom or ownership interests in an entity holding all or a portion of such investments and cease to be "investment advisers," as defined under Section 202(a)(11) of the Advisers Act;

f. before December 31, 2015, to remove 72 Credit as an investment adviser relying on the registration of SAC LP;

g. to submit to Sanjay Wadhwa, Senior Associate Regional Director (New York Regional Office), with a copy to the Office of Chief Counsel of the Enforcement Division, sworn certifications signed by Cohen every six months beginning December 31, 2014, and ending on the date that SAC LP and 72 Credit cease to be "investment advisers," as defined under Section 202(a)(11) of the Advisers Act, in which he affirms that from June 30, 2014 through the date of the affirmation, the undertakings in paragraph 15(d) above have been complied with; and

h. 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 any relevant exhibits, to the extent such exhibits would be necessary to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Sanjay Wadhwa, Senior Associate Regional Director (New York Regional

Office), with a copy to the Office of Chief Counsel of the Enforcement Division, no later than February 29, 2016.

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 pursuant to Section 203(e) of the Advisers Act that:

(A) Effective December 31, 2015, the registration of Respondent SAC LP as an investment adviser is revoked;

(B) Respondents shall comply with the undertakings enumerated in paragraph 15 above.

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. 72494 / June 27, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3561 / June 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15951

In the Matter of **CHRIS CHOI, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these

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

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

proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Choi, age 45, is and has been a certified public accountant licensed to practice in the State of California. He held several finance-related positions at Nvidia Corporation ("Nvidia") from 2005 until his resignation in May 2012.

2. Nvidia was, at all relevant times, a Delaware corporation headquartered in Santa Clara, California, that developed and sold graphics processors used in various computing devices. At all relevant times, Nvidia's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and was traded on the NASDAQ National Market.

3. On April 23, 2014, the Commission filed a complaint against Choi in the United States District Court for the Southern District of New York in SEC v. Choi (Civil Action No. 14-2879-SAS). On June 3, 2014, the court entered an order permanently enjoining Choi, by consent, from future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Choi was also ordered to pay a $30,000.00 civil money penalty and was barred for five years from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

4. The Commission's complaint alleges, among other things, that Choi – while working as an employee of Nvidia in 2009 and 2010 – obtained material nonpublic information about Nvidia's financial results and relayed that information to his friend Hyung Lim ("Lim"). By disclosing that information to Lim, Choi breached a fiduciary duty or obligation arising from a similar relationship of trust and confidence. The complaint further alleges that, in return for payment, Lim relayed Choi's information to Danny Kuo ("Kuo"), an analyst at Whittier Trust Company ("Whittier Trust"). Utilizing that information, funds managed by Whittier Trust reaped gains and avoided losses of about $295,000 by trading Nvidia securities in advance of Nvidia's quarterly earnings announcements on May 7, 2009, November 5, 2009, and November 11, 2010. Kuo also provided Choi's information to analysts at Diamondback Capital Management LLC, Level Global Investors LP, and Sigma Capital Management LLC, who used this information to generate profits and avoid losses of about $16.2 million for hedge funds managed by these three firms.

IV.

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

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

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

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

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

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

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

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

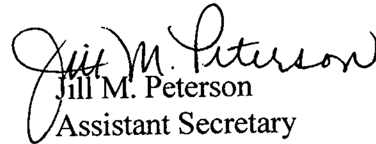
(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

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

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is

current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.



Jill M. Peterson
Assistant Secretary

Commissioner Stein Disapproved

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-31140; 812-14327]

BNP Paribas S.A., et al.; Notice of Application and Temporary Order

June 30, 2014

Agency: Securities and Exchange Commission ("Commission").

Action: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 ("Act").

Summary: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to guilty pleas entered on June 30, 2014 or shortly thereafter, by BNP Paribas S.A. ("BNPP") in the U.S. District Court for the Southern District of New York ("District Court") in connection with a plea agreement between BNPP and the U.S. Department of Justice and the Office of the U.S. Attorney for the Southern District of New York (together with the Department of Justice, the "DOJ"), and in the Supreme Court of the State of New York, County of New York ("NY Supreme Court"), in connection with a plea agreement between BNPP and the New York County District Attorney's Office ("DANY"), until the Commission takes final action on an application for a permanent order. Applicants have also applied for a permanent order.

Applicants: Fischer Francis Trees & Watts, Inc. ("FFTW"), Bishop Street Capital Management Corp. ("BSCM"), Impax Asset Management Ltd. ("IAM"), and BNPP (each an "Applicant" and collectively, the "Applicants").[1]

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[1] Applicants request that any relief granted pursuant to the application also apply to any existing or future company of which BNPP is or may become an affiliated person within the meaning of section 2(a)(3) of the Act

Filing Date: The application was filed on June 30, 2014. Applicants have agreed to file an amendment during the notice period, the substance of which is reflected in this notice.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on July 25, 2014, and should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants: Betty Whelchel, BNP Paribas S.A., 787 Seventh Avenue, New York, NY 10019, with a copy to Donald R. Crawshaw and Wendy M. Goldberg, Sullivan & Cromwell LLP, 125 Broad Street, New York, NY 10004.

For Further Information Contact: Kieran G. Brown, Senior Counsel, at (202) 551-6773 or Daniele Marchesani, Branch Chief, at (202) 551-6821 (Division of Investment Management, Chief Counsel's Office).

Supplementary Information: The following is a temporary order and a summary of the application. The complete application may be obtained via the Commission's website by searching for the file number, or an applicant using the Company name box, at http://www.sec.gov/search/search.htm or by calling (202) 551-8090.

(together with the Applicants, the "Covered Persons") with respect to any activity contemplated by section 9(a) of the Act.

Applicants' Representations:

1. BNPP is organized under the laws of France as a credit institution and is a major global bank active in seventy-five countries with key positions in its three main areas of activity: retail banking, investment solutions and corporate and investment banking. FFTW and BSCM are each indirect wholly-owned subsidiaries of BNPP. IAM is a subsidiary of a company listed on the Alternative Investment Market of the London Stock Exchange and BNPP indirectly owns 25.22% of such company's shares. FFTW, a corporation formed under the laws of New York, BSCM, a corporation formed under the laws of Hawaii, and IAM, a limited liability company formed under the laws of the United Kingdom, are each registered as an investment adviser under the Investment Advisers Act of 1940. FFTW, BSCM and IAM serve as investment adviser (as defined in section 2(a)(20) of the Act) to investment companies registered under the Act or series of such companies ("Funds") (such activities, "Fund Service Activities").

2. On June 30, 2014, the DOJ filed a notice of intent to file a one-count criminal information in the District Court and the DANY filed a two-count criminal information in the NY Supreme Court, respectively against BNPP. The DOJ's information, which was filed on July 1, 2014, charged BNPP with conspiracy to commit an offense against the United States in violation of Title 18, United States Code, Section 371, by conspiring to violate the International Emergency Economic Powers Act ("IEEPA"), codified at Title 50, United States Code, Section 1701 et seq., and regulations issued thereunder, and the Trading with the Enemy Act ("TWEA"), codified at Title 50, United States Code Appendix, Section 1 et seq., and regulations issued thereunder. DANY's information charged BNPP with the crime of falsifying business records in the first degree, in violation of Penal Law §175.10, and conspiracy in the fifth degree, in violation of Penal Law §105.05(1). BNPP has agreed to resolve the action brought by DANY

through a plea agreement dated June 30, 2014, and the action brought by the DOJ through a plea agreement to be entered in July 2014 (collectively, the "Plea Agreements"). Under the Plea Agreements, BNPP will plead guilty to the charges set out in the respective informations. Applicants expect that the District Court and the NY Supreme Court will enter judgments against BNPP that will require remedies that are materially the same as set forth in the Plea Agreements. Pursuant to the Plea Agreements, BNPP agreed to comply with the undertakings described in the application and to pay substantial criminal penalties and restitution.

3. BNPP will enter into a Cease and Desist Order Issued Upon Consent with the Board of Governors of the Federal Reserve System (the "Federal Reserve") and the French Authorité de Contrôle Prudentiel et de Résolution (the "ACPR") to resolve certain findings in connection with the conduct underlying the Plea Agreements (including the conduct described in any of the exhibits to the Plea Agreements) (the "Conduct") by the Federal Reserve and the ACPR (the "Federal Reserve/ACPR Order").

4. BNPP will enter into an Order to Cease and Desist and Order of Assessment of a Civil Money Penalty Issued Upon Consent with the Federal Reserve to resolve certain findings related to the Conduct by the Federal Reserve (the "Federal Reserve CMP Order").

5. BNPP will enter into a Consent Order related to the Conduct with the New York State Department of Financial Services ("DFS") with respect to falsifying business records and certain clearing activities (the "DFS Order").

6. BNPP also will enter into a Consent Order related to the Conduct with the United States Department of the Treasury's Office of Foreign Asset Control (the "OFAC Order").

7. Nine individuals who have been identified as having been responsible for the Conduct are current employees of BNPP or a Covered Person due to certain legal requirements

imposed by Swiss or French law, as applicable. These individuals are not and will not be active and will not be involved in the operations of any Applicant or Covered Person. All but two of the individuals identified as having been responsible for the Conduct that remain employees of BNPP or a Covered Person will have either resigned, retired, or been terminated no later than December 31, 2014. The remaining two employees are inactive and will be terminated when Swiss law permits. All other employees of BNPP and any Covered Person who were identified as having been responsible for the Conduct have either resigned or been terminated.

8. BNPP has agreed to lawfully undertake the following pursuant to the Plea Agreements: (1) BNPP has agreed to pay a monetary penalty in the amount of $8.8336 billion; (2) BNPP has agreed that any compliance consultant or monitor imposed by the Federal Reserve or DFS will submit every report it produces to each of the Federal Reserve, the DFS, and DANY; (3) BNPP has agreed to enhance its compliance policies and procedures with regard to U.S. sanctions laws and regulations; (4) BNPP has agreed to abide by the Federal Reserve/ACPR Order, the Federal Reserve CMP Order, and the DFS Order; and (5) BNPP has agreed to truthfully and completely disclose any information requested and completely and fully cooperate with DANY, the Federal Bureau of Investigation, the Internal Revenue Service Criminal Investigation and any other governmental agency designated by the DOJ or DANY. Additionally, BNPP is undertaking ongoing remediation efforts to strengthen its internal controls, making structural changes to its Compliance and Group Financial Security ("GFS") department and reviewing its business to ensure best practices with respect to U.S. dollar clearing and payment flows. These steps include upgrading their transaction filtering tools and streamlining alert management procedures. In addition, BNPP will physically transfer part of its GFS function from Paris to New York, and will operate the U.S. compliance function as a U.S. person. All BNPP majority-owned subsidiaries and branches have been instructed to implement

a process for the direction of all U.S. dollar clearing transactions through BNPP's New York branch.

Applicants' Legal Analysis:

1. Section 9(a)(1) of the Act provides, in pertinent part, that a person may not serve or act as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end investment company or registered unit investment trust, if such person within ten years has been convicted of any felony or misdemeanor arising out of such person's conduct, as, among other things, an investment adviser, a broker or dealer, or a bank. Section 2(a)(10) of the Act defines the term "convicted" to include a plea of guilty. Section 9(a)(3) of the Act extends the prohibitions of section 9(a)(1) to a company any affiliated person of which has been disqualified under the provisions of section 9(a)(1). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that BNPP is an affiliated person of each of the other Applicants within the meaning of section 2(a)(3). Applicants state that the Plea Agreements would result in a disqualification of each Applicant for ten years under section 9(a) of the Act because BNPP would become the subject of a conviction described in 9(a)(1).

2. Section 9(c) of the Act provides that the Commission shall grant an application for exemption from the disqualification provisions of section 9(a) if it is established that these provisions, as applied to Applicants, are unduly or disproportionately severe or that the Applicants' conduct has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c)

seeking temporary and permanent orders exempting the Applicants and other Covered Persons from the disqualification provisions of section 9(a) of the Act.

3. Applicants believe they meet the standard for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to them would be unduly and disproportionately severe and that the conduct of Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

4. Applicants assert that the Conduct did not involve any of Applicants acting as an investment adviser or depositor of any Fund, employees' securities company, or business development company or as principal underwriter for any open-end management investment company, unit investment trust, or face amount certificate company registered under the Act. The Conduct similarly did not involve any Fund with respect to which Applicants engaged in Fund Service Activities.[2] Applicants further assert that (i) none of the current or former directors, officers or employees of the Applicants (other than certain personnel of BNPP who were not involved in any of the Applicants' Fund Service Activities) had involvement in the Conduct; (ii) except as noted above, no current or former employee of BNPP or any Covered Person who previously has been or who subsequently may be identified by BNPP or any U.S. or non-U.S. regulatory or enforcement agencies as having been responsible for the Conduct will be an officer, director, or employee of FFTW, BSCM, or IAM, or of any other Covered Person; (iii) those identified employees have had no, and will not have any future, involvement in the Covered Persons' activities in any capacity described in section 9(a) of the Act; and (iv) because the personnel of the Applicants (other than certain personnel of BNPP who were not involved in any of the Applicants' Fund Service Activities) did not have any involvement in the Conduct,

2 BNPP does not engage, has not engaged, and will not engage in Fund Service Activities.

shareholders of the Funds were not affected any differently than if those Funds had received services from any other non-affiliated investment adviser.

5. Except as discussed above, Applicants have agreed that neither they nor any of the other Covered Persons will employ any of the current or former employees of BNPP or any Covered Person who previously have been or who subsequently may be identified by BNPP or any U.S. or non-U.S. regulatory or enforcement agencies as having been responsible for the Conduct in any capacity without first making a further application to the Commission pursuant to section 9(c). Applicants also have agreed that each Applicant (and any Covered Person that acts in any capacity described in section 9(a) of the Act) will adopt and implement policies and procedures reasonably designed to ensure compliance with the terms and conditions of the order granted under section 9(c). In addition, BNPP has agreed to comply in all material respects with the material terms and conditions of the Plea Agreements and the material terms of the Federal Reserve/ACPR Order, the Federal Reserve CMP Order, the DFS Order and the OFAC Order, all of which are described more fully in the application.

6. Applicants further represent that the inability of FFTW, BSCM, and IAM to continue providing Fund Service Activities would result in potential hardships for both the Funds and their shareholders. Applicants state that they will distribute written materials, including an offer to meet in person to discuss the materials, to the board of trustees/directors of the Funds, including the directors who are not "interested persons," as defined in section 2(a)(19) of the Act, of such Funds, and their independent legal counsel as defined in rule 0-1(a)(6) under the Act, if any, regarding the Plea Agreements, any impact on the Funds, and the application. The Applicants will provide the Funds with all information concerning the Plea Agreements and the

application that is necessary for the Funds to fulfill their disclosure and other obligations under the federal securities laws.

7. Applicants also state that, if FFTW, BSCM, and IAM were barred from providing Fund Service Activities to the Funds, the effect on their business and employees would be severe.

8. Applicants state that none of the Applicants and none of their affiliates previously have received orders under section 9(c).

Applicants' Conditions:

Applicants agree that any order granted by the Commission pursuant to the application will be subject to the following conditions:

1. Any temporary exemption granted pursuant to the application will be without prejudice to, and will not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including, without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

2. Except as set out in the second paragraph on Section IV.E. of the application, neither the Applicants nor any of the other Covered Persons will employ any of the current or former employees of BNPP or any Covered Person who previously have been or who subsequently may be identified by BNPP or any U.S. or non-U.S. regulatory or enforcement agencies as having been responsible for the Conduct in any capacity without first making a further application to the Commission pursuant to section 9(c).

3. Each Applicant and Covered Person will adopt and implement policies and procedures reasonably designed to ensure that it will comply with the terms and conditions of the requested orders within 60 days of the date on which any permanent order is granted or, with respect to condition four, such later date as may be contemplated by the Federal Reserve/ACPR Order, the Federal Reserve CMP Order, the DFS Order or the OFAC Order.

4. BNPP will comply in all material respects with the material terms and conditions of the Plea Agreements and with the material terms of the Federal Reserve/ACPR Order, the Federal Reserve CMP Order, the DFS Order and the OFAC Order.

5. Applicants will provide written notification to the Chief Counsel of the Commission's Division of Investment Management, with a copy to the Chief Counsel of the Commission's Division of Enforcement, of a material violation of the terms and conditions of the requested orders within 30 days of discovery of the material violation.

Temporary Order:

The Commission has considered the matter and finds that the Applicants have made the necessary showing to justify granting a temporary exemption.

Accordingly

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Applicants and the other Covered Persons are granted a temporary exemption from the provisions of section 9(a), effective forthwith, solely with respect to guilty pleas entered into pursuant to the Plea Agreements, subject to the representations and conditions in the application, until the date the Commission takes final action on their application for a permanent order.

By the Commission.

Jill M. Peterson
Assistant Secretary