SECURITIES AND EXCHANGE COMMISSION

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

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74624 / April 1, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3647 / April 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16469

In the Matter of **MARC J. MIZE,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Marc J. Mize ("Mize" 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, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Cease-And-Desist Proceedings, Pursuant to Section 21C Of The Securities Exchange Act of 1934, Making Findings, And Imposing A Cease-And-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. This case involves a fraudulent scheme by the owner (the "CEO") of four private telecommunications companies (collectively, "TelWorx") to inflate the value of assets that the companies sold to PCTEL, Inc. ("PCTEL"), a public company, and its wholly owned subsidiary PCTelWorx, Inc. ("PCTelWorx"). The scheme had two main components: first, to inflate the value of inventory and to prematurely recognize revenue prior to the sale in order to fraudulently inflate the sale price; and second, to conceal these facts from PCTEL by prematurely recognizing revenue after the asset purchase. Mize, an employee of TelWorx who joined PCTelWorx after the acquisition, participated in one of the fraudulent transactions – premature revenue recognition to meet a target revenue forecast – that was part of the scheme.

Respondent

2. **Marc J. Mize,** age 43, is a resident of High Point, North Carolina. From July 2012, until January 2013, he was the Senior Vice President of Sales and Tech Services of PCTelWorx.

Other Relevant Entities And Individuals

3. **PCTEL, Inc.** is a Delaware corporation with its principal place of business in Bloomingdale, Illinois. The company provides products and services for wireless communication networks. Its stock is traded on the NASDAQ (ticker symbol PCTI).

4. **PCTelWorx, Inc.** was a wholly owned subsidiary of PCTEL. PCTEL merged PCTelWorx into PCTEL on June 30, 2014.

5. **The CEO** was the owner and CEO of one of the TelWorx companies. After July 2012, the CEO was the general manager of PCTelWorx, whose responsibilities included its day-to-day operations and providing its quarterly revenue forecasts to PCTEL.

Background

6. In July of 2012, PCTEL and PCTelWorx acquired the assets of TelWorx. After the acquisition, the CEO ran PCTelWorx. Thereafter, PCTelWorx operated similarly to TelWorx.

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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.

7. Prior to the acquisition, Mize was a TelWorx employee. After the acquisition, he became an employee of PCTelWorx.

8. In the third and fourth quarter of 2012, PCTEL's publicly filed, consolidated financial statements included PCTelWorx's financial results.

Revenue Forecasts

9. Prior to the acquisition, the CEO provided PCTEL and PCTelWorx with TelWorx's revenue forecasts for the second quarter of 2012. Shortly before the acquisition, PCTEL learned that TelWorx did not meet the second quarter 2012 revenue forecast. This revenue shortfall was due, in part, to a large order that a customer ("Customer A") had postponed until the third quarter of 2012.

10. After the acquisition, PCTEL received PCTelWorx's revenue forecasts from the CEO on a quarterly basis. PCTelWorx employees, including Mize, knew that it was important to PCTEL's business that PCTelWorx meet or exceed the quarterly revenue forecasts it provided to PCTEL.

PCTelWorx Creates A False Order In The Third Quarter To Conceal Revenue Shortfall

11. Towards the end of the third quarter of 2012, PCTelWorx still had not received the large order from Customer A that the CEO forecasted for the third quarter, and the CEO realized that PCTelWorx would not meet its quarterly revenue forecast.

12. The CEO decided to improperly use an intermediate purchaser for Customer A's anticipated order to conceal the revenue forecast shortfall. The CEO proposed that the intermediate purchaser eventually would resell the products to Customer A at a profit. The CEO planned to offer the intermediate purchaser extended payment terms so that it could collect the full purchase price from Customer A before having to pay PCTelWorx's invoice. The CEO identified a vendor that provided services to – but that had not previously purchased a large order from – PCTelWorx (the "Vendor") as a potential intermediate purchaser.

13. Mize knew that the purpose of this false transaction was to artificially meet PCTelWorx's forecasted third quarter revenue. At the CEO's direction, Mize spoke to the Vendor about the CEO's proposal and obtained a purchase order with the same terms as the order that PCTelWorx expected eventually to receive from Customer A.

14. Using the purchase order obtained by Mize, the CEO instructed a PCTelWorx employee ("the Employee") to record the Vendor's order in PCTelWorx's books and records and to indicate that the order had been shipped to the Vendor and that the Vendor had been invoiced. These actions resulted in improper, premature revenue recognition in PCTelWorx's books and records during the third quarter.

15. However, PCTelWorx never shipped the products listed on the false order to the Vendor, nor did it send the invoice for the false order to the Vendor. PCTelWorx's books and records indicated that the Vendor's payment for the products was due and unpaid.

PCTelWorx Conceals Premature Revenue Recognition By Removing A Legitimate Customer Order From Its Books And Records In the Fourth Quarter

16. Midway through the fourth quarter, Customer A still had not placed the order with PCTelWorx expected by the CEO. In addition, the payment for the false order by the Vendor was overdue. The CEO became concerned that PCTEL would attempt to collect on the overdue invoice to the Vendor, detect the false order in its books and records and determine that PCTelWorx had recognized revenue prematurely in the third quarter.

17. The CEO decided to conceal from PCTEL the false third quarter order from Vendor B by reversing it from PCTelWorx's books and records and recording a new false transaction that matched an actual purchase order from another PCTelWorx customer ("Customer B"). According to the CEO's plan, Customer B's order would be cancelled on PCTelWorx's books, but Customer B would pay for the order placed by Vendor B.

18. At the CEO's instruction, Mize contacted the Vendor and obtained a revised, false purchase order that was identical to the order that PCTelWorx had received from Customer B. Mize knew that the purpose of this transaction was to conceal from PCTEL the false third quarter transaction with the Vendor by removing the false transaction from the third quarter from PCTelWorx's books and records and replacing it with a false transaction that would be paid for by Customer B in the fourth quarter.

19. The CEO and Mize, at the CEO's direction, then instructed the Employee to cancel Customer B's order and to reverse Vendor A's false order from the third quarter in PCTelWorx's books and records. The CEO and Mize, at the CEO's direction, also instructed the Employee to enter the Vendor's revised, false purchase order into PCTelWorx's books and records. Ultimately, the items supposedly ordered by the Vendor pursuant to the revised, false purchase order were shipped to – and paid for – by Customer B.

20. PCTEL discovered the false entries in PCTelWorx's books and records. PCTEL issued a Form 8-K/A on March 13, 2013, disclosing these irregularities but did not restate any financial information it previously reported.

Violations

21. As a result of the conduct described above, Mize violated Section 13(b)(5) of the Securities Act which prohibits the knowing falsification of any book, record, or account or circumvention of internal controls.

22. As a result of the conduct described above, Mize caused PCTEL's violation of Section 13(b)(2)(A) of the Exchange Act, which requires Section 12 registrants to make and keep

books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets.

23. As a result of the conduct described above, Mize violated Rule 13b2-1 of the Exchange Act, which prohibits the direct or indirect falsification of any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

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 21C of the Exchange Act, Mize cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(5) of the Exchange Act and Rule 13b2-1 promulgated thereunder.

B. Mize shall pay civil penalties of $25,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). Payment shall be made in $5,000 installments within 10, 90, 180, 270, and 360 days of the entry of this order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, 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 Marc J. Mize 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: Paul Montoya, Assistant

Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois 60604.

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74626 / April 1, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3649 / April 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16471

In the Matter of **TIMOTHY EDWIN SCRONCE** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Timothy Edwin Scronce ("Scronce" 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, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Cease-And-Desist Proceedings, Pursuant to Section 21C Of The Securities Exchange Act of 1934, Making Findings, And Imposing A Cease-And-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. This case involves a fraudulent scheme directed by Respondent, the owner of four private telecommunications companies (collectively, "TelWorx") to inflate the value of assets that the companies sold to PCTEL, Inc. ("PCTEL"), a public company, and its wholly owned subsidiary PCTelWorx, Inc. ("PCTelWorx"). The scheme had two main components: first, to inflate the value of inventory and to prematurely recognize revenue prior to the sale in order to fraudulently inflate the sale price; and second, to conceal these facts from PCTEL by prematurely recognizing revenue after the asset purchase. As a result of this scheme, TelWorx provided PCTEL materially false financial statements which were incorporated in a Commission filing.

Respondent

2. **Timothy Edwin Scronce,** age 49, is a resident of Winston-Salem, North Carolina. He was the majority owner and CEO of TelWorx Communications, LLC and controlled the day-to-day operations of TowerWorx, which were two of the TelWorx entities. After the sale of assets to PCTEL, Sconce became a Vice President of PCTEL and the general manager of PCTelWorx until he resigned on December 19, 2012. Previously, Respondent was the President and Chief Operating Officer of a publicly traded company.

Other Relevant Entities

3. **PCTEL, Inc.** is a Delaware corporation with its principal place of business in Bloomingdale, Illinois. The company provides products and services for wireless communication networks. Its stock is traded on the NASDAQ (ticker symbol PCTI).

4. **PCTelWorx, Inc.** was a wholly owned subsidiary of PCTEL. PCTEL merged PCTelWorx into PCTEL on June 30, 2014.

Background

5. In the first and second quarters of 2012, PCTEL and PCTelWorx negotiated with Respondent to acquire the assets of TelWorx. PCTEL and PCTelWorx relied, in part, on TelWorx's earnings before interest, taxes, depreciation, and amortization ("EBITDA") to determine the price it would pay to acquire the assets.

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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.

6. Consequently, Respondent understood that artificially increasing TelWorx's earnings would benefit him by increasing TelWorx's purchase price.

7. In July of 2012, PCTEL and PCTelWorx acquired TelWorx's assets for a total of $18 million, consisting of cash and an earn-out payment, based on PCTEL's 2013 financial performance and payable in PCTEL's common stock.

8. After the acquisition, Respondent operated and managed PCTelWorx similarly to the way he had operated and managed TelWorx.

9. In the third and fourth quarter of 2012, PCTEL's publicly-filed, consolidated financial statements included PCTelWorx's financial results, and Respondent was aware of this fact.

Revenue Forecasts

10. Prior to the acquisition, Respondent provided PCTEL and PCTelWorx with TelWorx's revenue forecasts for the second quarter of 2012.

11. After the acquisition, PCTEL received PCTelWorx's revenue forecasts from Respondent on a quarterly basis. Respondent knew that it was important to PCTEL's business that PCTelWorx meet or exceed the quarterly revenue forecasts he provided to PCTEL.

Before The Acquisition, False Entries In TelWorx's General Ledger Inflated Revenue and EBITDA

12. In April of 2012, Respondent directed TelWorx's controller (the "Controller") to make a false entry in TelWorx's general ledger which improperly inflated the value of certain obsolete telecommunications equipment ("the Modules") in TelWorx's inventory and improperly inflated TelWorx's EBITDA.

13. Subsequently, Respondent instructed the Controller to send TelWorx's accounting firm (the "Accountants") an email that falsely stated that the Modules were undervalued on TelWorx's general ledger and that the Controller had corrected this error.

14. In May of 2012, Respondent also directed the Controller to invoice certain customer orders before those orders had shipped, but to backdate the orders to the first quarter of 2012. The Controller generated invoices for these orders, which caused TelWorx to recognize revenue prematurely in its books and records in the first quarter of 2012.

15. Respondent then directed the Controller to provide TelWorx's income statements to the Accountants, which he did.

16. Respondent later directed the Controller to reverse these orders, thus reversing the revenue generated from these orders from TelWorx's books and records.

17. Near the end of the second quarter, PCTEL requested estimated second quarter revenue from TelWorx. Respondent instructed the Controller to send PCTEL an email providing

TelWorx's actual revenue for the first two months of the second quarter and estimated revenue for the final month of the second quarter.

18. Respondent then directed the Controller to re-invoice several of the orders Respondent had previously instructed the Controller to invoice and reverse, causing TelWorx to recognize revenue for these orders prematurely a second time.

19. These false accounting entries caused material overstatements of TelWorx's EBITDA and its first and second quarter 2012 revenue.

20. Respondent caused TelWorx to provide PCTEL with financial information that included these overstatements. These false accounting entries increased the purchase price which PCTEL paid for TelWorx.

21. Despite these false entries, TelWorx still did not meet the second quarter revenue forecast that Respondent had provided to PCTEL.

22. Shortly before the acquisition, PCTEL learned that TelWorx did not meet the second quarter 2012 revenue forecast. This revenue shortfall was due, in part, to a large order that a customer ("Customer A") had postponed until the third quarter of 2012.

PCTelWorx Recorded Revenue From Two False Transactions To Conceal The Pre-Acquisition Inventory Write-Up and Third Quarter Revenue Shortfall

23. After the acquisition, in the middle of the third quarter of 2012, PCTEL began performing inventory valuation testing at PCTelWorx, which would have included testing the Modules whose value Respondent directed the Controller to inflate prior to the acquisition.

24. In order to conceal this fact from PCTEL, Respondent told the Controller that he planned to purchase the Modules himself.

25. Even though Respondent was the purchaser, he subsequently instructed the Controller to make an entry in PCTelWorx's books and records showing an order for the Modules naming a PCTelWorx's vendor, a telecommunications company located in Taiwan ("Vendor A"), as the purchaser.

26. Respondent also instructed the Controller to create an invoice for this false order. The Controller carried out Respondent's instructions, which caused PCTelWorx to record a false order in its books and records and to recognize revenue on the false order prematurely.

27. Respondent paid PCTelWorx's invoice to Vendor A but concealed from PCTEL the fact that he had purchased the Modules himself. PCTelWorx never shipped the Modules to Vendor A.

28. Towards the end of the third quarter of 2012, Respondent realized that even with the revenue from Vendor A's false order, PCTelWorx still would not meet the quarterly revenue forecast he had provided to PCTEL.

29. Respondent also knew that PCTelWorx still had not received the large order from Customer A that he had forecast for the third quarter. So Respondent decided to improperly use an intermediate purchaser for Customer A's anticipated order to conceal the revenue forecast shortfall.

30. Respondent proposed that the intermediate purchaser eventually would resell the products to Customer A at a profit. Respondent planned to offer the intermediate purchaser extended payment terms so that it could collect the full purchase price from Customer A before having to pay PCTelWorx's invoice.

31. Respondent identified a vendor that provided services to – but that had not previously purchased a large order from – PCTelWorx ("Vendor B") as a potential intermediate purchaser.

32. Respondent instructed PCTelWorx's Vice President of Sales and Tech Services (the "Vice President") to ask Vendor B if it would act as the intermediate purchaser for this order.

33. The Vice President followed Respondent's direction and obtained a purchase order from Vendor B with the same terms as the order that PCTelWorx expected eventually to receive from Customer A.

34. Using the purchase order obtained by the Vice President, Respondent instructed a PCTelWorx employee ("Employee A") to record Vendor B's order in PCTelWorx's books and records and to indicate that the order had been shipped to Vendor B and that Vendor B had been invoiced. These actions resulted in improper, premature revenue recognition in PCTelWorx's books and records during the third quarter.

35. PCTelWorx never shipped the products listed on the false order to Vendor B, nor did it send Vendor B the invoice for the false order.

PCTelWorx Created False Documents In The Fourth Quarter To Conceal The Fake Orders From PCTEL

36. In the middle of the fourth quarter of 2012, PCTEL asked PCTelWorx to provide it with all of the records concerning Vendor A's order. Because it was a false order, most of the requested records, such as the purchase order and shipping records, did not exist.

37. In order to conceal the fact that Vendor A's order was false, Respondent instructed the Controller to request certain records for Vendor A's order by email from a PCTelWorx employee ("Employee B"). The Controller sent the email as Respondent instructed. However, Respondent knew that the records described in that email did not exist.

38. Respondent then created several false records concerning Vendor A's order that PCTEL had requested. He provided these records to Employee B, and instructed Employee B to email the records and other false information concerning Vendor A's order to the Controller, who then provided the false information and documents to PCTEL.

39. Midway through the fourth quarter, Customer A still had not placed the order with PCTelWorx as expected by Respondent. In addition, PCTelWorx's books and records indicated that Vendor B's payment for the order was due and unpaid. Respondent became concerned that PCTEL would attempt to collect on the overdue invoice to Vendor B, detect the false order in its books and records and determine that PCTelWorx had recognized revenue prematurely in the third quarter.

40. Respondent decided to conceal from PCTEL the false third quarter order from Vendor B by reversing it from PCTelWorx's books and records and recording a new false transaction that matched an actual purchase order from another PCTelWorx customer ("Customer B"). According to Respondent's plan, Customer B's order would be cancelled on PCTelWorx's books, but Customer B would pay for the order placed by Vendor B.

41. Respondent instructed the Vice President to obtain a revised, false purchase order from Vendor B that was identical to the order that PCTelWorx had received from Customer B.

42. Respondent and the Vice President, at Respondent's direction, then instructed Employee A to cancel Customer B's order and to reverse Vendor B's false order from the third quarter in PCTelWorx's books and records. Respondent and the Vice President, at Respondent's direction, also instructed Employee A to enter Vendor B's revised, false purchase order into PCTelWorx's books and records.

43. Ultimately, the items supposedly ordered by Vendor B pursuant to the revised, false purchase order were shipped to – and paid for – by Customer B.

After The Acquisition, PCTEL Filed A Form 8-K/A That Included TelWorx's Materially Overstated Second Quarter Revenue

44. PCTEL informed Respondent that it was required to file with the Commission pro-forma financial statements that included financial information for both PCTEL and TelWorx as if PCTEL had owned TelWorx for the first two quarters of 2012 and that it had retained the Accountants to prepare compilations of TelWorx's financial statements. Respondent agreed to release TelWorx's compiled financial statements to PCTEL for filing with the Commission.

45. On September 24, 2012, PCTEL filed a Form 8-K/A which reported TelWorx's audited financial statements for 2010 and 2011, an unaudited compilation of TelWorx's financial statements as of June 30, 2012, and PCTEL's unaudited pro forma consolidated financial statements that included financial information for both PCTEL and TelWorx as if PCTEL had acquired TelWorx as of January 1, 2011.

46. The Form 8-K/A materially overstated revenue on TelWorx's financial statements due to the false accounting entries made, at Respondent's direction.

47. On March 13, 2013, PCTEL issued a Form 8-K/A disclosing these irregularities.

PCTEL Confronts Scronce With The False Entries in TelWorx's And PCTelWorx's Books and Records

48. Notwithstanding Respondent's efforts to conceal from PCTEL the false entries in TelWorx's books and records and the false entries in PCTelWorx's books and records, PCTEL discovered the false entries.

49. PCTEL confronted Respondent about one of the false purchase orders and, shortly thereafter, Respondent resigned his position with PCTelWorx.

50. PCTEL and Respondent subsequently entered into a settlement agreement pursuant to which Respondent paid PCTEL a total of $4.75 million, $3.2 million of which represented the return of a portion of the purchase price PCTEL paid for TelWorx's assets, and gave up the right to receive any stock earn-out payments.

Violations

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

52. As a result of the conduct described above, Respondent acted through or by means of another person to violate Section 20(b) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder. Section 20(b) of the Exchange Act makes it unlawful for any person, directly or indirectly, to do an 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.

53. As a result of the conduct described above, Respondent violated Section 13(b)(5) of the Securities Act which prohibits the knowing falsification of any book, record, or account or circumvention of internal controls.

54. As a result of the conduct described above, Respondent caused PCTEL's violations of Section 13(a) of the Exchange Act and Rules 13a-11 and 12b-20 promulgated thereunder, which collectively require issuers of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission accurate current reports on Form 8-K that contain material information necessary to make the required statements made in the reports not misleading.

55. As a result of the conduct described above, Respondent caused PCTEL's violation of Section 13(b)(2)(A) of the Exchange Act, which requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets.

56. As a result of the conduct described above, Respondent violated Rule 13b2-1 of the Exchange Act, which prohibits the direct or indirect falsification of any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

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 21C of the Exchange Act, Respondent Scronce cease and desist from committing or causing any violations and any future violations of Section 10(b), 20(b), 13(a), 13(b)(2)(A), 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-11, and 13b2-1 promulgated thereunder.

B. Respondent Scronce be, and hereby is, prohibited, for ten years following the date of the 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 shall, within 10 days of the entry of this Order, pay disgorgement of $376,007, prejudgment interest of $29,212.47, and a civil money penalty in the amount of $140,000 to the Securities and Exchange Commission for transfer to the general fund of United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or 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 Timothy Edwin Scronce 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 Paul Montoya, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois 60604.

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74625 / April 1, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3648 / April 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16470

In the Matter of

MICHAEL HEDRICK,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Michael Hedrick ("Hedrick" 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, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Cease-And-Desist Proceedings, Pursuant to Section 21C Of The Securities Exchange Act of 1934, Making Findings, And Imposing A Cease-And-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. This case involves a fraudulent scheme by the owner ("the CEO") of four private telecommunications companies (collectively "TelWorx"), to inflate the value of assets that the companies sold to PCTEL, Inc. ("PCTEL"), a public company, and its wholly owned subsidiary PCTelWorx, Inc. ("PCTelWorx"). The scheme had two main components: first, to inflate the value of inventory and to prematurely recognize revenue prior to the sale in order to fraudulently inflate the sale price; and second, to conceal these facts from PCTEL by prematurely recognizing revenue after the asset purchase. As a result of this scheme, TelWorx provided PCTEL materially false financial statements which were incorporated in a Commission filing. Hedrick, at the CEO's direction, recklessly inflated the value of obsolete inventory before the acquisition and recorded revenue prematurely both before and after the acquisition.

Respondent

2. **Michael Hedrick**, age 30, is a resident of Lexington, North Carolina. From 2010 through July 2012, he was TelWorx's controller. From July 2012 until January 2013, he was controller of PCTelWorx. Hedrick does not have an accounting degree and is not a certified public accountant. Hedrick entered into a cooperation agreement with the Division of Enforcement during its investigation of this matter.

Other Relevant Entities And Individual

3. **PCTEL, Inc.** is a Delaware corporation with its principal place of business in Bloomingdale, Illinois. The company provides products and services for wireless communication networks. Its stock is traded on the NASDAQ (ticker symbol PCTI).

4. **PCTelWorx, Inc.** was a wholly owned subsidiary of PCTEL. PCTEL merged PCTelWorx into PCTEL on June 30, 2014.

5. **The CEO** was the owner and CEO of one of the TelWorx companies. After July 2012, the CEO became the general manager of PCTelWorx, whose responsibilities included its day-to-day operations and providing its quarterly revenue forecasts to PCTEL.

Background

6. In the first and second quarters of 2012, PCTEL and PCTelWorx negotiated with the CEO to acquire the assets of TelWorx. PCTEL and PCTelWorx relied, in part, on TelWorx's

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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.

earnings before interest, taxes, depreciation, and amortization ("EBITDA") to determine the price it would pay to acquire the assets.

7. The CEO informed Hedrick that he would receive a bonus for assisting with the due diligence related to the acquisition. Hedrick was responsible for providing financial information to PCTEL and TelWorx's accounting firm ("the Accountants").

8. In July of 2012, PCTEL and PCTelWorx acquired TelWorx's assets for cash and an earn-out payment based on PCTEL's 2013 financial performance and payable in PCTEL's common stock. Hedrick received a $25,000 bonus after PCTEL completed the acquisition.

9. Thereafter, PCTelWorx began operating similarly to TelWorx using the assets PCTEL acquired. The CEO operated and managed PCTelWorx and Hedrick served as its controller.

10. In the third and fourth quarter of 2012, PCTEL's publicly-filed, consolidated financial statements included PCTelWorx's financial results.

Before The Acquisition, False Entries In TelWorx's General Ledger Inflated Revenue and EBITDA

11. In April of 2012, the CEO directed Hedrick to make a false entry in TelWorx's general ledger which improperly inflated the value of certain obsolete telecommunications equipment ("the Modules") in TelWorx's inventory and improperly inflated TelWorx's EBITDA. Hedrick made the entry as directed.

12. Subsequently, the CEO instructed Hedrick to send the Accountants an email that falsely stated that the Modules were undervalued on TelWorx's general ledger and that Hedrick had corrected this error. By sending the email at the CEO's direction, Hedrick acted recklessly because the Modules were not undervalued.

13. In May of 2012, the CEO also directed Hedrick to invoice certain customer orders before those orders had shipped, but to backdate the orders to the first quarter of 2012. By generating the invoices at the CEO's direction, Hedrick acted recklessly because the orders had not yet shipped. As a result, TelWorx recognized revenue prematurely in its books and records in the first quarter of 2012.

14. The CEO then directed Hedrick to provide TelWorx's income statements to the Accountants, and Hedrick did so.

15. The CEO later directed Hedrick to reverse these orders, thus reversing the revenue generated from these orders from TelWorx's books and records. Hedrick reversed the orders as directed.

16. Near the end of the second quarter, PCTEL asked Hedrick to provide TelWorx's estimated second quarter revenue. The CEO instructed Hedrick to send PCTEL an email providing

TelWorx's actual revenue for the first two months of the second quarter and estimated revenue for the final month of the second quarter. Hedrick sent the email as directed.

17. The CEO then instructed Hedrick to re-invoice several of the orders the CEO had previously instructed Hedrick to invoice and reverse, and Hedrick did so. Hedrick acted recklessly because those orders had not yet shipped. As a result, TelWorx recognized revenue for these orders prematurely a second time.

18. These false accounting entries caused material overstatements of TelWorx's EBITDA and its first and second quarter 2012 revenue.

19. TelWorx provided PCTEL with financial information that included these overstatements.

20. The false accounting entries increased the purchase price which PCTEL paid for TelWorx.

PCTelWorx Recorded Revenue From A False Transaction To Conceal Pre-Acquisition Inventory Write-Up and Third Quarter Revenue Shortfall

21. After the acquisition, in the middle of the third quarter of 2012, PCTEL began performing inventory valuation testing at PCTelWorx, which would have included testing the Modules whose value Hedrick inflated at the CEO's direction prior to the acquisition.

22. In order to conceal this fact from PCTEL, the CEO told Hedrick that he planned to purchase the Modules himself.

23. Even though the CEO was the purchaser, he subsequently instructed Hedrick to make an entry in PCTelWorx's books and records showing an order for the Modules naming a PCTelWorx's vendor, a telecommunications company located in Taiwan (the "Vendor"), as the purchaser. Hedrick entered the order from the Vendor at the CEO's direction, which caused PCTelWorx to record a false order in its books and records.

24. The CEO also instructed Hedrick to generate an invoice for this false order. Hedrick did so at the CEO's direction, which caused PCTelWorx to recognize revenue on the order prematurely.

25. However, neither the invoice, nor the Modules themselves, were ever shipped to the Vendor.

PCTelWorx Created False Documents In The Fourth Quarter To Conceal The Fake Order From PCTEL

26. In the middle of the fourth quarter of 2012, PCTEL asked PCTelWorx to provide it with all of the records concerning the Vendor's order. Because it was a false order, most of the requested records, such as the purchase order and shipping records, did not exist.

27. In order to conceal the fact that the Vendor's order was false, the CEO instructed Hedrick to request certain records for the Vendor's order by email from another PCTelWorx employee (the "Employee"). Hedrick knew that most of the records the CEO had him request did not exist, but sent the email as the CEO instructed.

28. The CEO then created several false records concerning the Vendor's order that PCTEL had requested. He provided these records to the Employee, and instructed the Employee to email the records and other false information concerning the Vendor's order to Hedrick. Hedrick provided the false information and false documents to PCTEL.

After The Acquisition, PCTEL Filed A Form 8-K/A That Included TelWorx's Materially Overstated Second Quarter Revenue

29. On September 24, 2012, PCTEL filed a Form 8-K/A which reported TelWorx's audited financial statements for 2010 and 2011, an unaudited compilation of TelWorx's financial statements as of June 30, 2012, and PCTEL's unaudited pro forma consolidated financial statements that included financial information for both PCTEL and TelWorx as if PCTEL had acquired TelWorx as of January 1, 2011.

30. The Form 8-K/A materially overstated revenue on TelWorx's financial statements due to the false entries Hedrick made in TelWorx's general ledger at the CEO's direction.

31. Hedrick signed a representation letter to the Accountants in which he stated he had no knowledge of any fraud by TelWorx's management in connection with income statements TelWorx provided to the Accountants.

32. PCTEL discovered the false entries in TelWorx's books and records and the false entries in PCTelWorx's books and records. Hedrick provided PCTEL with information about what had occurred. PCTEL issued a Form 8-K/A on March 13, 2013, disclosing these irregularities but did not restate any financial information it previously reported.

Violations

33. As a result of the conduct described above, Hedrick caused violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, which prohibit fraudulent conduct[2] in connection with the purchase or sale of securities.

34. As a result of the conduct described above, Hedrick violated Section 13(b)(5) of the Securities Act which prohibits the knowing falsification of any book, record, or account or circumvention of internal controls.

35. As a result of the conduct described above, Hedrick caused PCTEL's violations of Section 13(a) of the Exchange Act and rules 13a-11 and 12b-20 promulgated thereunder, which

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[2] A knowing or reckless disregard of the truth is sufficient to establish the necessary scienter for a violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. *Aaron v. SEC,* 446 U.S. 680, 691 (1980).

collectively require issuers of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission accurate current reports on Form 8-K that contain material information necessary to make the required statements made in the reports not misleading.

36. As a result of the conduct described above, Hedrick caused PCTEL's violation of Section 13(b)(2)(A) of the Exchange Act, which requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets.

37. As a result of the conduct described above, Hedrick violated Rule 13b2-1 of the Exchange Act, which prohibits the direct or indirect falsification of any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Hedrick cease and desist from committing or causing any violations and any future violations of Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-11, and 13b2-1 promulgated thereunder.

B. Hedrick shall pay disgorgement of $25,000 and prejudgment interest of $2,072.62 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). Payment shall be made in five equal installments within 10, 90, 180, 270, and 360 days of the entry of the Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement and prejudgment interest plus any additional interest accrued pursuant to SEC Rule of Practice 600 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 Hedrick 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 Paul Montoya, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois 60604.

C. Respondent acknowledges that the Commission is not imposing a civil penalty based upon his cooperation in a Commission investigation and his agreement to cooperate in any related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay a civil money penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether he knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74621 / April 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16468

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate and 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 Urban AG Corporation ("Respondent" or "Urban AG").

II.

After an investigation, the Division of Enforcement alleges that:

RESPONDENT

1. Urban AG is a Delaware corporation with offices in North Andover, Massachusetts. Urban AG purported to provide hazardous material abatement and environment remediation services. Respondent has a class of equity securities registered with the Commission pursuant to Section 12(g) of the Exchange Act. As of November 21, 2014, Respondent's common stock (ticker "AQUM") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group, Inc., had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

DELINQUENT FILINGS

2. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers with classes of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires issuers to file quarterly reports.

3. The Respondent filed its last Form 10-Q for the quarter ended September 30, 2013 on November 19, 2013. Since then, the Respondent has not filed its required periodic reports.

4. The Respondent is delinquent in the following periodic filings:

Form	Period Ended	Due on or about
10-K	December 31, 2013	March 31, 2014
10-Q	March 31, 2014	May 15, 2014
10-Q	June 30, 2014	August 14, 2014
10-Q	September 30, 2014	November 14, 2014

5. As a result of the conduct described above, the Respondent has failed to comply with Section 13(a) of the Exchange Act 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 to institute public administrative proceedings to determine:

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

B. 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, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against 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 mail.

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74620 / April 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16467

In the Matter of **EARTH DRAGON RESOURCES, 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 and 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 Earth Dragon Resources, Inc. ("Respondent" or "Earth Dragon").

II.

After an investigation, the Division of Enforcement alleges that:

RESPONDENT

1. Earth Dragon is a Nevada corporation with offices in San Diego, California. Earth Dragon purported to be an exploration stage corporation engaged in the search for mineral deposits or mineral reserves. Respondent has a class of equity securities registered with the Commission pursuant to Section 12(g) of the Exchange Act. As of November 25, 2014, Respondent's common stock (ticker "EARH") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group, Inc., had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

DELINQUENT FILINGS

2. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers with classes of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires issuers to file quarterly reports.

3. The Respondent filed its last Form 10-Q for the quarter ended August 31, 2011 on October 3, 2012. Since then, the Respondent has not filed its required periodic reports.

4. The Respondent is delinquent in the following periodic filings:

Form	Period Ended	Due on or about
10-Q	November 30, 2011	January 14, 2012
10-Q	February 28, 2012	April 14, 2012
10-K	May 31, 2012	August 31, 2012
10-Q	August 31, 2012	October 15, 2012
10-Q	November 30, 2012	January 14, 2013
10-Q	February 28, 2013	April 14, 2013
10-K	May 31, 2013	August 31, 2013
10-Q	August 31, 2013	October 15, 2013
10-Q	November 30, 2013	January 14, 2014
10-Q	February 28, 2014	April 14, 2014
10-K	May 31, 2014	August 31, 2014
10-Q	August 31, 2014	October 15, 2014
10-Q	November 30, 2014	January 14, 2015

5. As a result of the conduct described above, the Respondent has failed to comply with Section 13(a) of the Exchange Act 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 to institute public administrative proceedings to determine:

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

B. 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, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against 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 mail.

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.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74619 / April 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16466

In the Matter of **KBR, Inc.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against KBR, Inc. ("KBR" or "Respondent").

II.

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

III.

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

Respondent

1. KBR, Inc. is a Delaware corporation headquartered in Houston, Texas. KBR's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the New York Stock Exchange. KBR files periodic reports, including reports on Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

[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

A. Statutory and Regulatory Framework Protecting Whistleblowers

2. The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted on July 21, 2010, amended the Exchange Act by adding Section 21F, "Whistleblower Incentives and Protection." The congressional purpose underlying these provisions was "to encourage whistleblowers to report possible violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees." *See* "Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934," Release No. 34-64545, at p. 198 (Aug. 12, 2011) (the "Adopting Release").

3. To fulfill this congressional purpose, the Commission adopted Rule 21F-17, which provides in relevant part:

> (a) No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications.

Rule 21F-17 became effective on August 12, 2011.

B. KBR's Confidentiality Statement

4. As part of its compliance program, KBR regularly receives complaints and allegations from its employees of potential illegal or unethical conduct by KBR or its employees, including allegations of potential violations of the federal securities laws. KBR's practice is to conduct internal investigations of these allegations. KBR investigators typically interview KBR employees (including the employees who originally lodged the complaint or allegation) as part of the internal investigations.

5. Prior to the promulgation of Rule 21F-17 and continuing into the time that Rule 21F-17 has been in effect, KBR has used a form confidentiality statement as part of these internal investigations. Although use of the form confidentiality statement is not required by KBR policy, the statement is included as an enclosure to the KBR Code of Business Conduct Investigation Procedures manual, and KBR investigators have had witnesses sign the statement at the start of an interview.

6. The form confidentiality statement that KBR has used before and since the SEC adopted Rule 21F-17 requires witnesses to agree to the following provisions:

> I understand that in order to protect the integrity of this review, I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment.

7. Though the Commission is unaware of any instances in which (i) a KBR employee was in fact prevented from communicating directly with Commission Staff about potential securities law violations, or (ii) KBR took action to enforce the form confidentiality agreement or otherwise prevent such communications, the language found in the form confidentiality statement impedes such communications by prohibiting employees from discussing the substance of their interview without clearance from KBR's law department under penalty of disciplinary action including termination of employment. This language undermines the purpose of Section 21F and Rule 21F-17(a), which is to "encourage[e] individuals to report to the Commission." Adopting Release at p. 201.

Remedial Steps Taken By KBR

8. KBR has amended its confidentiality statement to include the following statement:

> Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures.

Violation

9. Through its conduct described above, KBR violated Rule 21F-17 under the Exchange Act.

Undertaking

10. KBR has agreed to make reasonable efforts to contact KBR employees in the United States who signed the confidentiality statement from August 21, 2011 to the present, providing them with a copy of this Order and a statement that KBR does not require the employee to seek permission from the General Counsel of KBR before communicating with any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, regarding possible violations of federal law or regulation. In determining whether to accept the Offer, the Commission has considered this undertaking.

11. KBR has agreed to 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 David Peavler, Associate Regional Director, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent KBR cease and desist from committing or causing any violations and any future violations of Rule 21F-17 of the Exchange Act;

B. Respondent shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of $130,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). 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 KBR 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 David L. Peavler, Associate Regional Director, Fort Worth Regional Office, Division of Enforcement, Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Fort Worth, Texas, 76102.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: 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. 74646 / April 3, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16473

In the Matter of **HAIDER ZAFAR,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Haider Zafar ("Zafar" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From February 2013 to May 2013, Respondent solicited investors to enter into promissory note agreements, claiming, as a result of his family's finances and influence, he had access to an investment opportunity whereby investors could invest a large sum of money and obtain significant returns, even doubling their investments, in a short period of time. Respondent acted as a broker but has never been registered with the Commission in any capacity. Respondent, 37 years old, is a resident of Miami-Dade County, Florida.

B. ENTRY OF THE RESPONDENT'S CRIMINAL CONVICTION

2. On September 22, 2014, a guily plea was entered whereby Respondent pled guilty to a 5-count indictment alleging wire fraud in violation of Title 18 of the United States Code, Section 1343 before the United States District Court for the Southern District of Florida, in U.S. v. Haider Zafar, Case No. 14-CR-20617.

3. The counts of the indictment to which Respondent pled guilty alleged, inter alia, that Respondent knowingly, and with intent to defraud, devised and intended to devise, a scheme and artifice to defraud others and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, and that he knowingly transmitted and caused to be transmitted, by means of wire communication in interstate commerce, certain writings, signs, signals, pictures and sounds.

4. Respondent acted as an unregistered broker. Respondent held himself out as a broker, solicited investors, and controlled the investment of funds pursuant to the promissory notes issued to investors. The counts of the indictment to which Respondent pled guilty further alleged that Respondent, among other things, raised approximately $7.5 million from three investors, which Respondent then misappropriated. Respondent misrepresented to the investors that the funds would be invested in an investment opportunity for a short period of time to quickly obtain a significant return. To further induce investors and foster the appearance of credibility, Respondent fabricated a story about his connection to an influential Pakistani family. Furthermore, Respondent received transaction-based compensation in the form of misappropriated funds and spent investor money on personal expenses, including several luxury vehicles and payment for a Miami Heat season-ticket package.

5. On January 16, 2015, the Court sentenced Zafar to 46 months in prison and was ordered to forfeit title and interest in assets and pay restitution in the amount of $3,524,469.00, which represents the remaining amount of gross proceeds of the fraud.

III.

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

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

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

IV.

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

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

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

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74658 / April 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16474

In the Matter of **China Education International, Inc., Delta Entertainment Group Inc., and Gulf United 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. China Education International, Inc. ("CEII") (CIK No. 1367898) is a Nevada corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CEII is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of $16,202,446 for the prior nine months. As of April 3, 2015, the common stock of CEII was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had six market makers and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Delta Entertainment Group Inc. ("DENG") (CIK No. 1481199) is a Florida corporation located in Fort Lauderdale, Florida with a class of securities registered with the

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

Commission pursuant to Exchange Act Section 12(g). DENG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of $510,891 for the prior nine months. As of April 3, 2015, the common stock of DENG 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. Gulf United Energy, Inc. ("GLFE") (CIK No. 1312165) is a Nevada corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GLFE is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of $12,867,509 for the prior nine months. As of April 3, 2015, the common stock of GLFE 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

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 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 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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74661 / April 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16476

In the Matter of AuraSound, Inc., C2C CrowdFunding, Inc., Convenience TV Inc., Global Security Agency Inc., and NewMarket Technology, Inc., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS[1]

1. AuraSound, Inc. ("ARUZQ") (CIK No. 810208) is a dissolved Nevada corporation located in Santa Ana, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ARUZQ 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, 2011. On December 21, 2012, ARUZQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which was closed on November 25, 2014. As of April 3, 2015, the common stock of ARUZQ was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had six

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

market makers and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. C2C CrowdFunding, Inc. ("CRWD") (CIK No. 1417900) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CRWD 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 September 30, 2012, which reported a net loss of $53,937 for the prior year. As of April 3, 2015, the common stock of CRWD was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Convenience TV Inc. ("CRPZ") (CIK No. 1454719) is a revoked Nevada corporation located in Venice, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CRPZ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of $151,168 for the prior six months. As of April 3, 2015, the common stock of CRPZ 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. Global Security Agency Inc. ("GSAG") (CIK No. 1399761) is a revoked Nevada corporation located in Conroe, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GSAG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of $652,040 for the prior nine months. As of April 3, 2015, the common stock of GSAG 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. NewMarket Technology, Inc. ("NWMT") (CIK No. 1092083) is a revoked Nevada corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NWMT 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 a comprehensive loss of $1,222,783 for the prior six months. As of April 3, 2015, the common stock of NWMT was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

7. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current

and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74659 / April 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16475

In the Matter of **Chatter Box Call Center Ltd., Euro Group of Companies, Inc., and Golden Century Resources Limited,** **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. Chatter Box Call Center Ltd. ("CXLLE") (CIK No. 1368294) is a void Delaware corporation located in Shantin, New Territories, Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CXLLE 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, 2011, which reported a net loss of $48,995 for the prior nine months. As of April 3, 2015, the common stock of CXLLE was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had three market makers and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Euro Group of Companies, Inc. ("EGCO") (CIK No. 1005663) is a void Delaware corporation located in New Haven, Connecticut with a class of securities registered with the

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

Commission pursuant to Exchange Act Section 12(g). EGCO 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 $82,415 for the prior six months. As of April 3, 2015, the common stock of EGCO was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Golden Century Resources Limited ("GDLM") (CIK No. 1378625) is a void Delaware corporation located in Wilmington, Delaware with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GDLM 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 $346,456 for the prior nine months. As of April 3, 2015, the common stock of GDLM was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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 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 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: 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. 74667 / April 7, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4055 / April 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16477

In the Matter of

DANIEL R. MURPHY,

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 Daniel R. Murphy ("Murphy" 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 Sections III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 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. Murphy, age 71, is a resident of Jacksonville, Florida. Murphy is a managing partner of Chadbourn Partners, LLC ("Chadbourn"), which is a Florida limited liability company with its principal place of business in Jacksonville, Florida.

2. From August 1989 to December 2011, Murphy was associated with various broker-dealers and one investment adviser registered with the Commission. From January 2012 to August 2012, Murphy was a registered principal associated with a broker-dealer registered with the Commission, which was also a state-registered investment adviser.

3. On August 15, 2014, in the civil action entitled Rome v. Chadbourn Partners, LLC, a/k/a Chadbourn Partners, Inc.; Daniel R. Murphy; and Henry Dyer Wiggins, Jr., Case No. 14CV30611, filed by the Securities Commissioner for the State of Colorado, by and through the Colorado Attorney General ("Colorado Securities Commissioner"), the District Court, City and County of Denver, Colorado entered an Order of Permanent Injunction and Other Relief as to Defendant Daniel R. Murphy permanently enjoining Murphy from, among other things, associating in any capacity with any broker-dealer, investment adviser, or investment adviser representative engaged in business in Colorado, or associating in any capacity with any individual or entity engaged in the offer, purchase, or sale of securities or any investment in or from Colorado, and entering judgment against Murphy in the amount of $879,000. Murphy stipulated to the injunction and judgment on a neither admit nor deny basis.

4. The Colorado Securities Commissioner's Complaint against Murphy alleged that, between September 2010 and February 2012, Murphy, through Chadbourn, engaged in securities fraud and the unlawful sale of unregistered securities by raising $879,000 from mostly unsophisticated and elderly Colorado investors by selling investments in Chadbourn debentures. The Complaint alleged that Murphy failed to provide the Colorado investors with critical information about the securities, including failing to disclose the risk involved, that investor funds would be used for personal expenses, and that the securities were not registered as required by law.

IV.

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

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Murphy be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74674 / April 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16479

In the Matter of JOSEPH J. ALMAZON AND SPARTAN CAPITAL PARTNERS, Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Joseph J. Almazon and Spartan Capital Partners ("Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. At all relevant times, Almazon was the sole officer, director and owner of Executive Source Holding, LLC ("Executive Source"), a Delaware liability company. He also owned and controlled an unincorporated business that operated in Hicksville, New York under the name Spartan Capital Partners ("Spartan"). Respondent Almazon, age 26, resides in Hicksville, New York. Almazon, Executive Source and Spartan were not registered with the Commission in any capacity. At all relevant times, Almazon was an associated person of a registered broker-dealer.

B. ENTRY OF THE INJUNCTION

2. On March 15, 2012, a judgment was entered by consent against Almazon and Spartan, permanently enjoining them from future violations of Sections 5(a) and 5(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. Mattera, et al., Civil Action Number 1:11-CV-08323, in the United States District Court for the Southern District of New York ("District Court").

3. The Commission's complaint alleged that, beginning in approximately June 2011, Almazon, acting through interns hired to work for Spartan, solicited investments in Delaware limited liability companies Praetorian G IV, V and VI (the "Praetorian G Entities"). Each of the limited liability companies was a special purpose vehicle that purportedly held, but did not hold, shares of popular privately-held companies such as Facebook, Inc., Groupon, Inc. and Zynga, Inc. Almazon and Spartan successfully solicited investments totaling at least $640,000. Almazon received transaction-based compensation in connection with each investment, in part by having investors transfer their funds to Executive Source and keeping a "markup" before transferring the investment to the designated investment account for the Praetorian G Entities, and in part by receiving a commission on each investment. Almazon was not an associated person of a registered broker or dealer with respect to the conduct alleged in the Complaint.

4. In marketing the securities of the Praetorian G Entities to potential investors, Almazon failed to disclose that he and related entities would receive a commission on each investment, and that they would also keep a markup, for total compensation of approximately 13-20% of the investment amount. This information was material to investors.

5. In ruling on the appropriate civil penalty to be assessed against Almazon, the District Court found, based solely on Almazon's own deposition testimony, that "[g]iven that Praetorian was attempting to induce his investment, Almazon's reliance on" the advice of Praetorian personnel about the legality of his participation in the offering was "unreasonable." The Court held that Almazon's "disregard of regulatory requirements was negligent," and it ordered Almazon to disgorge $390,376.95 (over $300,000 of which remains unpaid) and to pay prejudgment interest thereon. It also ordered Almazon to pay a penalty of $50,000.

C. ADDITIONAL SECURITIES-RELATED CONDUCT

6. On August 9, 2012, Almazon submitted to a registered broker-dealer offering prime brokerage services ("Prime Broker"), a purported "$15 million U.S. Treasury note" to be used as margin for a brokerage account that he was considering opening at Prime Broker. Although the document purported to obligate the United States Treasury to pay the bearer $15 million on demand, it was not a valid or enforceable instrument.

III.

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

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

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

IV.

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

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

If either 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 as provided for in the Commission's Rules of Practice.

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74686 / April 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16481

In the Matter of **Arctos Petroleum Corp., (a/k/a Stetson Oil & Gas, Ltd.), Cormac Mining Inc., and Gemini Tea 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 Arctos Petroleum Corp. (a/k/a Stetson Oil & Gas, Ltd.), Cormac Mining Inc., and Gemini Tea Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Arctos Petroleum Corp. (a/k/a Stetson Oil & Gas, Ltd.) (CIK No. 1082518) is a Yukon Territory, Canada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Arctos Petroleum is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2003, which reported a net loss of $612,000 for the prior twelve months. As of March 9, 2015, the company's stock (symbol "SSNOF") was traded on the over-the-counter markets.

2. Cormac Mining Inc. (CIK No. 1443270) 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). Cormac Mining is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2012, which reported a net loss of $93,913 from the company's January 17, 2007 inception through March 31, 2012.

3. Gemini Tea Corp. (CIK No. 1487202) is a dissolved Nevada corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Gemini Tea is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2011, which reported a net loss of $73,463 from the company's February 2, 2010 inception through November 30, 2011.

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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74684 / April 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16480

In the Matter of AOB Biotech, Inc., Argen Corp., Asia Link, Inc., Beleza Luxury Goods, Inc., and Beyond Golden Holdings 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 AOB Biotech, Inc., Argen Corp., Asia Link, Inc., Beleza Luxury Goods, Inc., and Beyond Golden Holdings Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. AOB Biotech, Inc. (CIK No. 1363449) is a suspended California corporation located in Pasadena, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AOB Biotech is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended April 12, 2007, which reported a net loss of $88,733 for the prior three months.

2. Argen Corp. (CIK No. 1098860) is a void Delaware corporation located in Whittier, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Argen is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2005.

3. Asia Link, Inc. (CIK No. 1377201) is a delinquent Colorado corporation located in La Mesa, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Asia Link 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 December 31, 2006, which reported a net loss of $5,000 from the company's December 29, 2005 inception to December 31, 2006.

4. Beleza Luxury Goods, Inc. (CIK No. 1407043) 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). Beleza Luxury Goods is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 8-A registration statement on May 1, 2009.

5. Beyond Golden Holdings Ltd. (CIK No. 1493571) is a British Virgin Islands corporation located in Road Town, Tortola, British Virgin Islands with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Beyond Golden Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/R registration statement on February 10, 2011.

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chair White
Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74673 / April 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16478

In the Matter of **FLIR SYSTEMS, INC.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against FLIR Systems, Inc. ("FLIR" 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, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. This matter concerns violations of the anti-bribery, books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA") by FLIR. In 2009, employees of FLIR provided unlawful travel, gifts and entertainment to foreign officials in the Kingdom of Saudi Arabia to obtain or retain business. The travel and gifts included personal travel and expensive watches provided by employees in FLIR's Dubai office to government officials with the Saudi Arabia Ministry of Interior (the "MOI"). The extent and nature of the travel and the value of the gifts were concealed by certain FLIR employees and, as a result, were falsely recorded in FLIR's books and records. FLIR

[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.

lacked sufficient internal controls to detect and prevent the improper travel and gifts. Also, from 2008 through 2010, FLIR provided significant additional travel to the same MOI officials, which was booked as business expenses, but for which there is insufficient supporting documentation to confirm the business purpose. As a result of the unlawful conduct, FLIR earned over $7 million in profits from the sales to the MOI.

Respondent

2. **FLIR Systems, Inc.** is an Oregon-based corporation whose common stock is registered under Section 12(b) of the Exchange Act and is listed on the NASDAQ Global Select Market. FLIR, founded in 1978, develops infrared technology for use in thermal imaging and other sensing products and systems, night vision, and camera systems for government and commercial customers. On September 30, 2002, in connection with a settled accounting fraud case, the Commission ordered FLIR to cease and desist from violations of the anti-fraud and related provisions of the federal securities laws.

FLIR's Business with the Saudi Ministry of Interior

3. Stephen Timms ("Timms") was the head of FLIR's Middle East office in Dubai during the relevant time period, and was one of the company executives responsible for obtaining business for FLIR's Government Systems division from the MOI. Yasser Ramahi ("Ramahi") reported to Timms and worked in business development in Dubai.[2] Both Timms and Ramahi were employees of FLIR.

4. In November 2008, FLIR entered into a contract with the MOI to sell binoculars using infrared technology for approximately $12.9 million. Ramahi and Timms were the primary sales employees responsible for the contract on behalf of FLIR. In the contract, FLIR agreed to conduct a "Factory Acceptance Test," attended by MOI officials, prior to delivery of the binoculars to Saudi Arabia. The Factory Acceptance Test was a key condition to the fulfillment of the contract. FLIR anticipated that a successful delivery of the binoculars, along with the creation of a FLIR service center, would lead to an additional order in 2009 or 2010.[3]

"World Tour"

5. In February 2009, Ramahi and Timms began preparing for the July 2009 Factory Acceptance Test. Ramahi and Timms then made arrangements to send MOI officials on what Timms later referred to as a "world tour" before and after the Factory Acceptance Test. Among the MOI officials for whom Ramahi and Timms provided the "world tour" were the head of the MOI's technical committee and a senior engineer on the committee, who played a key role in the decision to award FLIR the business.

6. The trip proceeded as planned, with stops in Casablanca, Paris, Dubai and Beirut. While in the Boston area, the MOI officials spent a single 5-hour day at FLIR's

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2 On November 17, 2014, the Commission instituted settled cease-and-desist proceedings against Timms and Ramahi for their role in this same conduct.

3 At the same time, Ramahi and Timms were also involved in FLIR's negotiations to sell security cameras to the MOI. In May 2009, FLIR signed an agreement for the integration of its cameras into another company's products for use by the MOI. The contract was valued at approximately $17.4 million and FLIR hoped to win additional future business with the MOI under this agreement.

Boston facility completing the equipment inspection. The agenda for their remaining seven days in Boston included just three other 1-2 hour visits to FLIR's Boston facility, some additional meetings with FLIR personnel, at their hotel, and other leisure activities, all at FLIR's expense. At the suggestion of Timms' manager, a U.S.-based Vice President responsible for global sales to foreign governments, Ramahi also took the MOI on a weekend trip to New York while they were in Boston. In total, the MOI officials traveled for 20 nights on their "world tour," with airfare and luxury hotel accommodations paid by FLIR. There was no business purpose for the stops outside of Boston.

7. Timms forwarded the air travel expenses for the MOI to his manager for approval, attaching a summary reflecting the full extended routing of the travel. The manager approved the travel, directing him to make the expenses appear smaller by "break[ing] it in 2 [submissions.]" Timms also forwarded the travel charges and an itinerary showing the Paris and Beirut stops, to FLIR's finance department. FLIR's finance department processed and paid the approved air expenses the next day. Neither Timms' manager nor anyone in FLIR's finance department questioned the itinerary or the travel expense, although the itinerary reflected travel to locations other than Boston.

8. After receiving questions from Timms' manager, Ramahi and Timms later claimed that the MOI's "world tour" had been a mistake. They told the FLIR finance department that the MOI had used FLIR's travel agent in Dubai to book their own travel and that it had been mistakenly charged to FLIR. They then used FLIR's third-party agent to give the appearance that the MOI paid for their travel. Timms also oversaw the preparation of false and misleading documentation of the MOI travel expenses that was submitted to FLIR finance as the "corrected" travel documentation. FLIR finance then made an additional payment to the Dubai travel agency for the remaining travel costs.

9. Following the equipment inspection in Boston, the MOI gave its permission for FLIR to ship the binoculars. The MOI later placed an order for additional binoculars for an approximate price of $1.2 million. In total, FLIR earned revenues of over $7 million in profits in connection with its sales of binoculars to the MOI.

Additional Travel

10. From 2008 through 2010, FLIR paid approximately $40,000 for additional travel by MOI officials. For example, Ramahi took the same MOI officials who went on the "world tour" to Dubai over the New Year holiday in December 2008 and again in 2009. FLIR paid for airfare, hotel, and expensive dinners and drinks. FLIR also paid for hotels, meals and first class flights for the MOI officials to travel within Saudi Arabia to help FLIR win business with other Saudi government agencies. Although the trips were booked as business expenses, the supporting documentation is incomplete and it is not possible to determine whether all the trips in fact had a business purpose.

11. Moreover, in June and July of 2011, a FLIR regional sales manager accompanied nine officials from the Egyptian Ministry of Defense on travel paid for by a FLIR partner. The travel centered on a legitimate Factory Acceptance Test at FLIR's Stockholm factory. The travel, however, also included a non-essential visit to Paris, during which the officials spent only two days on demonstration and promotion activities relating to FLIR products. In total, the government officials traveled for 14 days and most of the officials only participated in legitimate business activities on four of those days. Three officials engaged in two additional days of training in Sweden. The total travel costs were approximately $43,000. FLIR subsequently reimbursed the partner for the majority of the travel costs, based upon cursory invoices which were submitted without supporting documentation.

Expensive Watches

12. At Timms' and Ramahi's instruction, in February 2009, FLIR's third-party agent purchased five watches in Riyadh, paying approximately 26,000 Saudi Riyal (about U.S. $7,000). Ramahi and Timms gave the watches to MOI officials during a mid-March 2009 trip to Saudi Arabia to discuss several business opportunities with the MOI. The MOI officials who received the watches included two of the MOI officials who subsequently went on the "world tour" travel.

13. Within weeks of his visit to Saudi Arabia, Timms submitted an expense report to FLIR for reimbursement of the watches. The expense report clearly identified the watches as "EXECUTIVE GIFTS: 5 WATCHES" costing $1,425 each. Shortly thereafter, Timms specified that the watches were given to MOI officials, and identified the specific officials who received the watches.

14. Despite these red flags, the reimbursement was approved by Timms' manager and, based on that approval and the submitted invoices, FLIR's finance department paid the reimbursement to Timms.

15. In July 2009, in connection with an unrelated review of expenses in the Dubai office, FLIR's finance department flagged Timms' reimbursement request for the watches. In response to their questions, Timms claimed that he had made a mistake and falsely stated that the expense report should have reflected a total of 7,000 Saudi Riyal (about $1,900) for the watches, rather than $7,000 as submitted. Ramahi also told FLIR investigators that the watches were each purchased for approximately 1,300-1,400 Saudi Riyal (approximately $377) by FLIR's third-party agent. In September 2009, at Timms' direction, FLIR's agent maintained the false cover story in response to emailed questions from FLIR's finance department. Timms and Ramahi also obtained a false invoice reflecting that the watches cost 7,000 Saudi Riyal, which Timms submitted to FLIR finance in August 2009. The false, revised invoice was processed by FLIR.

FLIR's FCPA-Related Policies and Training and Internal Controls

16. During the relevant time, FLIR had a code of conduct, as well as a specific anti-bribery policy, which prohibited FLIR employees from violating the FCPA. FLIR's policies required employees to record information "accurately and honestly" in FLIR's books and records, with "no materiality requirement or threshold for a violation." FLIR employees, including Timms and Ramahi, received training on their obligations under the FCPA and FLIR's policy, although the company did not ensure that all employees, including Ramahi, completed the required training.

17. FLIR had few internal controls over travel in its foreign sales offices at the time. Although FLIR had policies and procedures over travel for its domestic operations, there were no controls or policies in place governing the use of foreign travel agencies. Instead, FLIR foreign sales employees worked directly with FLIR's foreign travel agencies to arrange travel for themselves and others. Sales managers, such as Timms, were solely responsible for expense approvals for their sales staff. Timms' manager was responsible for approving travel-related expenses for all non-U.S.-based senior sales employees (such as Timms) and approving the payment of large invoices to the foreign travel agencies.

18. FLIR also had few controls over the giving of gifts to customers, including foreign government officials. Sales staff and managers were responsible for all expense approvals for gifts and accounts payable was not trained to flag expenses that were potentially problematic. To the contrary, the initial expense submission for the watches

was labeled in large English print "EXECUTIVE GIFTS: 5 WATCHES" for a total of $7,123, and was accompanied by email confirmation that the watches were provided to 5 MOI "officers," when it was approved by Timms' manager and processed and paid by FLIR accounts payable department.

Remedial Efforts

19. In November 2010, FLIR received a complaint letter from FLIR's third-party agent, and began an investigation that lead to the discovery of the improper watches and travel. FLIR subsequently self-reported the conduct to the Commission and cooperated with the Commission's investigation.

20. Subsequent to the conduct described herein, FLIR undertook significant remedial efforts including personnel and vendor terminations. FLIR broadened its relevant policies and trainings and implemented a gift policy. FLIR enhanced access by its employees to its anti-bribery policy by providing translations into languages spoken in all countries in which it has offices. FLIR is in the process of enhancing its travel approval system in its foreign offices, including requiring all non-employee travel to be booked through either one large, designated travel agency or a limited number of designated regional travel agencies after receiving advance written approval from senior business personnel and the legal department. All travel agencies will be vetted through FLIR's full FCPA due diligence framework, be subject to all of FLIR's current FCPA training obligations, and cannot be reimbursed for travel bookings for non-employees in the absence of appropriate approvals. FLIR added additional FCPA training and procedures for its finance staff, and enhanced its third-party diligence process and contracts. FLIR also engaged outside counsel and forensic accountants to conduct a compliance review of travel and entertainment expenses in its operations outside the U.S.

Legal Standards and FCPA Violations

21. Under Section 21C(a) of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act or any rule or regulation thereunder, and upon any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation.

22. Section 30A of the Exchange Act prohibits any issuer with a class of securities registered pursuant to Section 12 of the Exchange Act, or any officer, director, employee, or agent acting on behalf of such issuer, in order to obtain or retain business, from corruptly giving or authorizing the giving of, anything of value to any foreign official for the purposes of influencing the official or inducing the official to act in violation of his or her lawful duties, or to secure any improper advantage, or to induce a foreign official to use his influence with a foreign governmental instrumentality to influence any act or decision of such government or instrumentality. [15 U.S.C. § 78dd-1].

23. Under Section 13(b)(2)(A) of the Exchange Act issuers are required to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer. [15 U.S.C. § 78m(b)(2)(A)].

24. Under Section 13(b)(2)(B) of the Exchange Act issuers are required to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (I) to permit

preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. [15 U.S.C § 78m(b)(2)(B)].

25. As described above, FLIR violated Section 30A of the Exchange Act by corruptly providing expensive gifts of travel, entertainment, and personal items to the MOI officials to retain and obtain business for FLIR. Respondent also violated Section 13(b)(2)(B) of the Exchange Act, by failing to devise and maintain a sufficient system of internal accounting controls to prevent the provision and approval of the watches and the travel and the falsification of FLIR's books and records to conceal the conduct. As a result of this same conduct, FLIR failed to make and keep accurate books and records in violation of Section 13(b)(2)(A) of the Exchange Act.

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 21C of the Exchange Act, Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A), 13(b)(2)(B) and 30A of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B), and 78dd-1].

B. Pursuant to Section 21(B)(a)(2) of the Exchange Act, Respondent shall, within 10 days of the entry of this Order, pay disgorgement of $7,534,000, prejudgment interest of $970,584 and a civil money penalty in the amount of $1,000,000, for a total payment of $9,504,584, to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC Web site 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 FLIR 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 Tracy L. Davis, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104.

C. Respondent shall report to the Commission staff periodically, at no less than nine-month intervals during a two-year term, the status of its compliance review of its overseas operations and the status of its remediation and implementation of compliance measures. During this two-year period, should Respondent discover credible evidence, not already reported to the Commission, that questionable or corrupt transfers of property or interests may have been offered, promised, paid or authorized by Respondent entity or person, or any entity or person acting on behalf of Respondent, or that related false books and records have been maintained, Respondent shall promptly report such conduct to the Commission staff. During this two-year period, Respondent shall: (1) conduct an initial review and submit an initial report, and (2) conduct and prepare at least two follow-up reviews and reports as described below:

(1) Respondent shall submit to the Commission staff a written report within 180 calendar days of entry of this Order setting forth a complete description of its Foreign Corrupt Practices Act ("FCPA") and anti-corruption related remediation efforts to date, its proposals reasonably designed to improve the policies and procedures of Respondent for ensuring compliance with the FCPA and other applicable anti-corruption laws, the parameters of the subsequent reviews, and the status and findings of its ongoing compliance review (the "Initial Report"). The Initial Report shall be transmitted to Charles E. Cain, Deputy Chief, FCPA Unit, Division of Enforcement, Securities and Exchange Commission, 100 F. Street, NE, Washington, DC, 20549-5030. Respondent may extend the time period for issuance of the Initial Report with prior written approval of the Commission staff.

(2) Respondent shall undertake at least two follow-up reviews, incorporating any comments provided by the Commission staff on the previous report, to update on the status and findings of its ongoing compliance review and to further monitor and assess whether the policies and procedures of Respondent are reasonably designed to detect and prevent violations of the FCPA and other applicable anti-corruption laws (the "Follow-Up Report").

(3) The Follow-Up Report shall be completed no later than 270 days after the Initial Report. The second Follow-Up Report shall be completed no later than 270 days after the completion of the first Follow-Up Report. Each Follow-Up Report shall be transmitted to Charles E. Cain at the address listed above. Respondent may extend the time period for the issuance of the Follow-Up Report with prior written approval of the Commission staff.

(4) The periodic reviews and reports submitted by Respondent will likely include proprietary, financial, confidential, and competitive business information. Public disclosure of the reports could discourage cooperation, impede pending or potential government investigation or undermine the objectives of the reporting

requirement. For these reasons, among others, the reports and the contents thereof are intended to remain and shall remain non-public, except (1) pursuant to court order, (2) as agreed by the parties in writing, (3) to the extent the Commission staff determines in its sole discretion that disclosure would be in furtherance of the Commission's discharge of its duties and responsibilities, or (4) is otherwise required by law.

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 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9745 / April 9, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74698 / April 9, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3651 / April 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16484

In the Matter of **MICHAEL M. COHEN** **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 M. Cohen ("Cohen" or "Respondent") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . [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.

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, 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. Cohen, age 49, is a resident of West Orange, New Jersey. Beginning in September 2006, Cohen served as the President, Chief Executive Officer ("CEO"), and Chairman of the Board of Directors of Proteonomix, Inc. ("Proteonomix" or the "company"). In September 2010, Cohen also took over the positions of Chief Financial Officer ("CFO") and Chief Operating Officer. Cohen has never been licensed as a certified public accountant. In his capacity as Proteonomix's CEO and CFO, Cohen signed and certified the accuracy of the company's reports and financial statements filed with the Commission until, as described below, the company terminated the registration of its common stock with the Commission.

2. Proteonomix is a Delaware corporation with its principal place of business in Paramus, New Jersey. Proteonomix is a biotechnology company engaged in, among other things, the discovery and development of stem cell therapeutics and cosmeceutical products. On August 4, 2009, Proteonomix filed a Form 10 with the Commission to register a class of common stock pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78l(g)]. Proteonomix filed its first Form 10-Q quarterly report with the Commission on September 11, 2009. The company's stock traded initially on the OTC Pink Sheets market and, subsequently, on the OTCBB under the symbol "PROT." On November 13, 2012, the company filed a Form 15, terminating the registration of its common stock with the Commission.

3. Respondent has entered into a written agreement to plead guilty to criminal conduct relating to the findings in the Order. Specifically, in *United States v. Michael Cohen*, Crim. No. 2:15-cr-00091-MCA-1 (D.N.J.), Respondent agreed to plead guilty to a one-count information, which charges him with knowingly certifying false financial statements in violation of 18 U.S.C. § 1350.

4. On February 19, 2015, the Commission filed a complaint against Cohen in *SEC v. Michael M. Cohen, et al.*, Case No. 2:15-cv-01292-MCA-JBC (D.N.J.). On March 6, 2015, the court entered a judgment permanently enjoining Cohen, by consent, from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77e(a), 77e(c), and 77q(a)]; Sections 10(b) and 13(b)(5) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78m(b)(5)]; Exchange Act Rules 10b-5, 13a-14, and 13b2-1 [17 C.F.R. §§ 240.10b-5, 240.13a-14, and 240.13b2-1]; and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and

13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(a), 78m(b)(2)(A), and 78m(b)(2)(B)], and Exchange Act Rules 12b-20, 13a-1, and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, and 240.13a-13]. The judgment also, by consent, permanently barred Cohen, pursuant to Section 20(e) of the Securities Act [15 U.S.C. § 77t(e)] and Section 21(d)(2) of the Exchange Act [15 U.S.C. § 78u(d)(2)], from serving as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. 78o(d)]; and permanently barred Cohen, pursuant to Section 20(g) of the Securities Act [15 U.S.C. § 77t(g)] and Section 21(d)(6) of the Exchange Act [15 U.S.C. § 78u(d)(6)], from participating in any offering of a penny stock, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of any penny stock. In addition, by consent, the judgment provided that the court will order disgorgement, prejudgment interest, and a civil penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] upon motion of the Commission.

5. The Commission's complaint alleged, among other things: that Proteonomix and Cohen fraudulently issued and transferred millions of Proteonomix shares to entities that Cohen secretly controlled; that Cohen directed the issuance and transfer of Proteonomix shares, and the subsequent sale of those shares into the open market, to generate undisclosed proceeds for his own benefit; that Proteonomix and Cohen falsely recorded share issuances and transfers on Proteonomix's accounting books and records as repayments of loans that did not exist or payments for consulting services that were not performed; that Proteonomix and Cohen failed to disclose related party transactions in filings with the Commission, as required by Generally Accepted Accounting Principles; that Cohen directed the transfer of shares of Proteonomix stock without restrictive legends under circumstances where the transactions were not registered with the Commission and no exemption from the registration provisions applied; and that Cohen falsely certified the accuracy of reports and statements that Proteonomix filed with the Commission.

IV.

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

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

By the Commission.

Brent J. Fields
Secretary

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

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9744 / April 9, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74691 / April 9, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3650 / April 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16033

In the Matter of

AIRTOUCH COMMUNICATIONS, INC., HIDEYUKI KANAKUBO, AND JEROME KAISER, CPA,

Respondents.

ORDER MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE AS TO JEROME KAISER

I.

On August 22, 2014, the Securities and Exchange Commission ("Commission") instituted proceedings 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 AirTouch Communications, Inc., Hideyuki Kanakubo, and Jerome Kaiser, CPA (collectively, "Respondents"), and additionally as to Kaiser, pursuant to Section 4C[1] of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

II.

Respondent Jerome Kaiser 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, and except as provided herein in Section V, Respondent Kaiser consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice as to Jerome Kaiser ("Order"), as set forth below.

III.

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

Summary

1. This matter involves fraudulent financial misstatements by AirTouch, a Newport Beach, California issuer, its founder and former president and CEO Kanakubo, and its former CFO and corporate secretary Jerome Kaiser, CPA ("Kaiser"), in the company's voluntarily filed Form 10-Q for the third quarter of 2012, and to an investor in connection with a $2 million loan made to the company in the fall of 2012.

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

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

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

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

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

2. In the third quarter of 2012, AirTouch improperly recognized net revenues of $1.031 million based on $1.24 million of inventory shipped to a Florida entity. This revenue recognition was improper because, as Kanakubo and Kaiser knew, or were reckless in not knowing, a fulfillment and logistics agreement executed contemporaneously with the Florida entity's purchase order—and upon which the purchase order was conditioned—relieved that entity of any obligation to pay AirTouch unless and until an AirTouch customer purchased the inventory. Kanakubo and Kaiser also knowingly, recklessly or negligently made false representations and omissions about this revenue to an AirTouch investor and lender. This conduct in inflating the revenues and obtaining financing was also deceptive and constituted a scheme to defraud.

3. In early 2013, AirTouch filed a Form 8-K disclosing its intention to restate net revenues for the third quarter of 2012, based on erroneous revenue recognition.

Respondents

4. **AirTouch Communications, Inc.** is a Delaware corporation with its principal place of business in Newport Beach, California. AirTouch's common stock is quoted on the OTC Pinks under the symbol "ATCH." AirTouch develops and sells telecommunications equipment designed to integrate mobile telephones into landline telephone systems within a consumer's home.

5. **Hideyuki Kanakubo** resides in Irvine, California. He is AirTouch's founder and former president, CEO, and director. At all relevant times, Kanakubo was responsible for the management of AirTouch's business. As of May 31, 2014, Kanakubo beneficially owned or controlled 1,858,143 shares of AirTouch common stock, or 9% of the company's total outstanding shares. Kanakubo resigned as president and CEO in March 2013.

6. **Jerome Kaiser, CPA** resides in Santa Barbara, California. Kaiser is a licensed Certified Public Accountant in California and an active member in the AICPA and California Society of Public Accountants. Kaiser holds a BS in Accounting and an MS in Business Taxation. He is AirTouch's former CFO and corporate secretary. At all relevant times, Kaiser was responsible for the management of AirTouch's business. As of May 31, 2014, Kaiser owned options to acquire 520,096 shares of AirTouch common stock at a strike price of $2 per share. He resigned from AirTouch in April 2013.

Background

7. In or around early 2012, AirTouch developed a new product, the "U250 SmartLinx", designed for sale to Mexico's largest provider of landline telephone services (the "Mexican Entity").

8. On July 30, 2012, AirTouch contacted a Florida provider of logistics and fulfillment services (the "Florida Entity") about the possibility of warehousing AirTouch's U250 SmartLinx product for possible sale to the Mexican Entity. AirTouch had never done business with the Florida Entity prior to July 30, 2012.

9. During contract negotiations related to this potential warehousing arrangement, the Florida Entity's CEO told Kanakubo that the Florida Entity was not buying any product from AirTouch, but rather would only warehouse the U250 SmartLinx inventory for eventual delivery to the Mexican Entity or other customers of AirTouch. AirTouch's salesperson relayed the same information to Kaiser.

10. On July 30, 2012, Kaiser sent Kanakubo a Fulfillment and Logistics Agreement between AirTouch and the Florida Entity (the "Agreement"), asking him to immediately review and sign it, which Kanakubo did. The Agreement included, among other terms, the following provisions:

a) "Section 3 (Orders and Acceptance): [The Florida Entity]'s purchase orders are subject to purchase orders by [the Mexican Entity] and/or any other customer that may be assigned from time to time by AirTouch. In the event [the Mexican Entity] or any of the customers does not fulfill the purchase orders and/or cancels the orders, [the Florida Entity] shall have the right to return these products to AirTouch and obtain a full credit equal to the original purchase amount with no offsets or deductions or any kind.";

b) "Section 5 (Resale to [the Mexican Entity] and/or Assigned Customers by AirTouch): [The Florida Entity] shall store the merchandise until shipment of the Products and shall invoice AirTouch for storage of the products, in/out control, invoicing, stock reconciliation, at 1.5% of the invoice value for the first 30 days and an additional 1% for each additional 30 days."; and

c) "Section 6 (Payment): [The Florida Entity] shall pay for Products in 90 days in accordance with the payment terms invoiced by AirTouch. However, [the Florida Entity] shall not be obligated to pay AirTouch until the Products have been received by [the Mexican Entity] and [the Florida Entity] has received full payment therefor, at which time then [the Florida Entity] shall pay AirTouch for the Products within 10 days thereafter."

11. The same day, the Florida Entity issued a $1.74 million "purchase order" for 20,000 U250 SmartLinx (the "Purchase Order"). The Purchase Order stated a payment term of "Net 90" but also stated that its payment terms were "according to term sheet." The Agreement was the "term sheet." Kaiser received emails where representatives of the Florida Entity described the Purchase Order as "conditional" upon AirTouch's execution of the Agreement. Kanakubo was also made aware that the Florida Entity would not issue the Purchase Order unless AirTouch first executed the Agreement.

12. On July 31, 2012, the Florida Entity sent Kaiser the counter-signed Agreement and the Purchase Order in a single email. Before forwarding this email to AirTouch's controller, he deleted the Agreement as an attachment, and forwarded only the Purchase Order.

13. AirTouch shipped approximately $1.24 million of inventory to the Florida Entity during the third quarter of 2012, pursuant to the Agreement and the Purchase Order.

AirTouch recognized revenue on all $1.24 million of inventory shipped to the Florida Entity during the quarter.

14. In October 2012, in connection with AirTouch's quarterly review, AirTouch's controller provided its outside auditor with a copy of the Purchase Order, but not the Agreement. The outside auditor did not receive the Agreement since Kaiser had never provided AirTouch's controller with the agreement.

15. When discussing the purported receivable AirTouch booked from the Florida Entity at board meetings, Kanakubo and Kaiser did not inform AirTouch's outside directors, including the chairman of the audit committee, that shipments to the Florida Entity were controlled by the Agreement.

16. AirTouch did not receive any payment from the Florida Entity during the third quarter of 2012, and likewise received no commitment from the Mexican Entity that it would buy product shipped to the Florida Entity, or otherwise.

1. AirTouch's Form 10-Q for the Third Quarter 2012

17. On November 14, 2012, AirTouch filed its Form 10-Q for the third quarter of 2012, reporting net revenues of $1,031,747. Without the revenue recognized on the inventory shipped to the Florida Entity, AirTouch would not have had any positive revenue for the quarter.

18. Under Generally Accepted Accounting Principles ("GAAP"), revenue cannot be recognized unless it is "realized or realizable" and "earned."

19. AirTouch's recognition of revenues for the inventory shipped to the Florida Entity did not comply with GAAP. Because AirTouch did not sell any product to the Florida Entity—the Purchase Order and the Agreement merely documented, for tracking purposes, the transfer of AirTouch inventory to the Florida Entity in contemplation of future sales—the revenue associated with shipments to the Florida Entity was not realized, realizable or earned.

20. AirTouch's revenue recognition policy, which was disclosed in the 10-Q and was consistent with the requirements of GAAP, permitted the recognition of revenue only where: "(1) persuasive evidence of an arrangement exists in the form of an accepted purchase order or equivalent documentation; (2) delivery has occurred, based on shipping terms, or services have been provided; (3) the company's price to the buyer is fixed or determinable, as documented on the accepted purchase order or similar documentation; and (4) collectability is reasonably assured."

21. Given the terms of the Purchase Order and the Agreement, AirTouch had no reasonable assurance of collectability from the Florida Entity because AirTouch did not have a valid receivable to collect from the Florida Entity.

22. Kanakubo and Kaiser signed certifications intended to be made pursuant to the Sarbanes-Oxley Act of 2002, stating that the Form 10-Q fairly presented AirTouch's financial condition and results.

23. Kanakubo and Kaiser knew, or were reckless in not knowing, that AirTouch's Form 10-Q contained materially false or misleading statements concerning reported net revenues and compliance with GAAP or AirTouch's revenue recognition policy.

24. The false and misleading statements in AirTouch's Form 10-Q occurred in connection with the purchase or sale of securities.

25. The false and misleading statements in AirTouch's Form 10-Q were material. These statements would have been viewed by a reasonable investor as significantly altering the total mix of available information, given that AirTouch would not have had any positive revenues for the quarter if it did not recognize the revenue from the Florida Entity. The Form 10-Q also reflected AirTouch's largest revenues ever reported for a quarter.

26. Kanakubo and Kaiser each knew about the Agreement but did not provide it to others involved in AirTouch's financial reporting process, including the controller, the chairman of the audit committee, and the company's outside auditor. This and other deceptive conduct contributed to a revenue recognition scheme and operated as a fraud.

27. Because of Kanakubo's and Kaiser's positions as AirTouch's senior management, their scienter is attributable to AirTouch.

28. At all relevant times, Kanakubo and Kaiser were the company's principal officers; they were the members of management in charge of AirTouch's day-to-day management, policies, and operations; and they were responsible for preparing and signing AirTouch's SEC filings.

2. Misstatements and Omissions Made to an Investor

29. In or around 2012, Kanakubo and Kaiser solicited a short term bridge loan from an existing AirTouch investor ("Investor A"), in exchange for a promissory note and a warrant to purchase 100,000 shares of AirTouch common stock. Investor A recommended the loan and warrant acquisition opportunity to a related entity, for which he served as the authorized agent during the due diligence process.

30. On October 3, 2012, Kanakubo falsely told Investor A by email that the inventory to be shipped by AirTouch to the Florida Entity—which he mischaracterized as an "authorized fulfillment house" for the Mexican Entity—pertained to an existing purchase order from the Mexican Entity.

31. Around the same time, Kaiser provided Investor A's representatives with the Purchase Order, but did not provide them with or disclose the existence of the Agreement.

32. On October 17, 2012, AirTouch received the loan of $2 million from Investor A in exchange for a warrant to purchase its common stock.

33. On October 19, 2012, Kanakubo approved a $15,000 bonus payment to Kaiser for his work on raising capital. The same day, Kanakubo authorized a $15,000 payment to himself in connection with unused vacation time.

34. Kanakubo and Kaiser knew, or were reckless in not knowing, that their statements to Investor A concerning revenues from the Florida Entity were materially false and misleading.

35. Kanakubo and Kaiser also failed to act with reasonable care because they did not ensure that Investor A was provided with all material information necessary to make their statements to him concerning the inventory shipped to the Florida Entity not misleading.

36. The false and misleading statements and omissions to Investor A occurred in the offer or sale of, and in connection with the purchase or sale of, securities.

37. Kanakubo's and Kaiser's false and misleading statements to Investor A, and their failure to disclose the terms of the Agreement, were material. Kanakubo's and Kaiser's statements to Investor A, and the terms of the Agreement, would have been viewed by a reasonable investor as significantly altering the total mix of available information because, among other reasons, AirTouch had not sold any of the inventory warehoused with the Florida Entity to the Mexican Entity, and thus had no basis to represent that it expected to collect revenue from the Florida Entity.

38. Kanakubo and Kaiser persuaded Investor A over several months into loaning AirTouch $2 million based on a distorted view of AirTouch's financial relationships with the Mexican Entity and the Florida Entity. They led Investor A to believe that AirTouch would receive a substantial financial commitment from the Mexican Entity, which would then provide AirTouch with sufficient cash flow for AirTouch to service and repay the loan. These inducements by Kanakubo and Kaiser, along with other deceptive conduct, contributed to an offering fraud scheme and a fraudulent transaction.

39. Because of Kanakubo's and Kaiser's positions as AirTouch's senior management, their scienter and their negligence are attributable to AirTouch.

40. At all relevant times, Kanakubo and Kaiser were the company's principal officers; there were the members of management in charge of AirTouch's day-to-day management, policies, and operations; and they were responsible for negotiating with Investor A, providing Investor A with due diligence materials, and for preparing and signing AirTouch's SEC filings.

3. AirTouch's Restatement

41. In January 2013, AirTouch's board of directors commenced an internal investigation concerning the net revenues reported in the Form 10-Q for the third quarter of 2012.

42. AirTouch's board of directors and its outside auditor subsequently received the Agreement, and determined to restate reported revenues for the third quarter of 2012.

43. AirTouch filed a Form 8-K on February 7, 2013, announcing errors in revenue recognition and the intention to file an amended Form 10-Q. No amended Form 10-Q has been filed.

Violations

44. As a result of the conduct described above, Respondent Kaiser 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 the offer and sale of securities and in connection with the purchase or sale of securities.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Respondent Kaiser shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Kaiser is prohibited, pursuant to Section 8A(f) of the Securities Act and Section 21C(f) of the Exchange Act, for ten years following the date of 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 Kaiser is denied the privilege of appearing or practicing before the Commission as an accountant.

D. After ten years from the date of this Order, Respondent Kaiser 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 Kaiser'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 Kaiser, 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 Kaiser, 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 his or the firm's quality control system that would indicate that he will not receive appropriate supervision;

(c) Respondent Kaiser 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 Kaiser acknowledges his responsibility, as long as he 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.

E. The Commission will consider an application by Respondent Kaiser 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 Kaiser's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

F. Respondent Kaiser shall, within 365 days of the entry of this Order, pay a civil money penalty in the amount of $60,000 to the Securities and Exchange Commission for transfer to the general fund of United States Treasury in accordance with Section 21F(g)(3) of the Exchange Act. If timely payment is not made, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent Kaiser may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent Kaiser 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 Kaiser 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 Kaiser 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 Diana Tani, Assistant Regional Director, Enforcement, Securities and Exchange Commission, Los Angeles Regional Office, 444 South Flower St., Suite 900, Los Angeles, CA 90071.

G. Respondent Kaiser shall, within 365 days of the entry of this Order, pay disgorgement of $15,000, which represents profits gained as a result of the conduct described herein, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Section 21F(g)(3) of the Exchange Act. If timely payment is not made, any interest accrued pursuant to SEC Rule of Practice 600, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent Kaiser may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent Kaiser 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 Kaiser 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 Kaiser 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 Diana Tani, Assistant Regional Director, Enforcement, Securities and Exchange Commission, Los Angeles Regional Office, 444 South Flower St., Suite 900, Los Angeles, CA 90071.

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 Kaiser, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Kaiser 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 Kaiser 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74696 / April 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16482

In the Matter of Molex Incorporated Respondent.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Molex Incorporated ("Molex" or "Respondent").

II.

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

III.

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

Summary

1. From at least 1989 to April 2010, Katsuichi Fusamae, a senior finance employee and controller at Molex Japan Co., Ltd. ("Molex Japan"), the Japanese subsidiary of the U.S.-based public company Molex Incorporated ("Molex"), engaged in a financial fraud that spanned more than 20 years and resulted in losses to Molex in excess of $200-million. Fusamae was responsible for investing Molex Japan's excess cash in conservative investments such as treasuries and commercial paper. Beginning in at least the late 1980s, Fusamae invested Molex Japan's cash in riskier investments contrary to Molex policy. For years, Fusamae engaged in risky equity trading, including margin trading, and suffered massive trading losses in excess of $110 million. In order to conceal his unauthorized trading and the associated losses and in an attempt to recover the losses, Fusamae caused Molex Japan to enter into a series of unauthorized borrowings whereby Fusamae used the loan proceeds to replenish the diminished trading accounts. At its peak, Fusamae had accumulated approximately $222 million of unauthorized loans. As a result of Fusamae's scheme, Molex filed materially misstated financial statements with the Commission over several years that failed to account for Molex Japan's trading losses and loans. Also as a result of the scheme, Molex and Molex Japan failed to make and keep accurate books and records reflecting Molex Japan's trading and borrowings. Fusamae falsified certain records related to Molex's accounts, including account reconciliations and year-end bank confirmation letters provided to outside auditors. Fusamae's scheme also exposed several deficiencies in Molex Japan's internal controls, which prevented the company from identifying and stopping the scheme. In fact, Molex did not discover Fusamae's scheme until he stopped showing up to work and sent a confession letter to the company in April 2010. As a result of this combination of factors, Fusamae successfully concealed his trading losses and the unauthorized borrowings for more than two decades.

Respondent

2. Molex Incorporated, a Delaware corporation headquartered in Lisle, Illinois, designs, manufactures, and sells electronic components. Until December 2013, Molex's common stock was registered with the Commission under Section 12(b) of Exchange Act and traded on the NASDAQ. On December 9, 2013, all of Molex's outstanding shares were acquired by a private corporation, and Molex's common stock was delisted.

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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.

Other Relevant Entities/Persons

3. Molex Japan Co., Ltd., a Japanese corporation headquartered in Yamato, Japan, is a wholly-owned subsidiary of Molex. Molex Japan has historically been Molex's largest and most profitable foreign subsidiary. During the relevant period, Molex Japan's financial statements were incorporated into Molex's consolidated financial statements filed with the Commission on Molex's Forms 10-K and 10-Q.

4. Katsuichi Fusamae, age 68, is a Japanese citizen who resides in Kanagawa, Japan. Fusamae was an employee of Molex Japan's financial group from July 1975 to April 2010. Beginning in at least 2003, Fusamae was Molex Japan's controller. Fusamae has been unemployed since April 2010.

Fusamae's Scheme

5. Beginning in at least the late 1980s and continuing until April 2010, Katsuichi Fusamae, a senior finance employee and controller of Molex Japan, engaged in a financial fraud that resulted in losses in excess of $200-million. Fusamae engaged in unauthorized trading in the company's brokerage accounts, concealed massive trading losses by taking out unauthorized and undisclosed loans in the company's name, and manipulated Molex Japan's accounting records to avoid detection.

6. Fusamae's responsibilities included investing Molex Japan's excess cash. Molex restricted cash investments for all of its entities, including Molex Japan, to certificates of deposit, government treasury bills, European currency deposits, and prime corporate paper. However, beginning in at least the late 1980s, Fusamae began investing the company's excess cash in riskier securities, including substantial trading of equities on margin. No one at Molex or Molex Japan authorized Fusamae to engage in the riskier trading, nor were they aware of his trading activities.

7. Shortly after Fusamae began his unauthorized trading, Molex Japan began suffering substantial losses on Fusamae's investments. Initially, Fusamae concealed the trading losses in the Molex Japan brokerage accounts by borrowing money in Molex Japan's name from Molex Japan's broker-dealers and moving the borrowed funds into the brokerage accounts temporarily at the end of each fiscal year. By doing so, Fusamae was able to provide auditors with account statements with values that matched the brokerage account balances on Molex Japan's books. Fusamae also had the banks and brokerage firms from which he borrowed funds send their year-end balance confirmation letters directly to him. Fusamae then would manually alter the letters and return them to Molex Japan's outside auditors in the original envelope. Fusamae continued to trade with borrowed funds, including margin trading, in an attempt to recover his losses, but instead he compounded the losses.

8. As the losses in Molex Japan's brokerage accounts mounted, the loans from the broker-dealers were insufficient to conceal the losses, and Fusamae began taking out unauthorized and undisclosed loans in Molex Japan's name from several Japanese banks. At its peak, the

amount of Molex Japan's outstanding unauthorized and undisclosed loans totaled approximately $222 million.

9. In April 2010, Fusamae was unable to secure additional funds to conceal his unauthorized and undisclosed trading and borrowing. He stopped showing up for work and sent a confession letter to Molex Japan's office. Molex Japan terminated Fusamae shortly thereafter.

10. At the time Fusamae confessed to the scheme, the outstanding balance of the unauthorized loans totaled $172.8 million. In total, Fusamae's scheme caused losses of approximately $201.9 million, which consisted primarily of $118.8 million in unauthorized trading losses, interest expense on his unauthorized loans, and approximately $20.5 million of unaccounted for loan proceeds from Fusamae's unauthorized borrowing.

Molex's Inaccurate Periodic Reports

11. Fusamae's concealment of his trading losses and unauthorized loans had a material impact on Molex's financial statements. Molex Japan never accounted for these loans and trading losses in its financial statements, which were incorporated into Molex's consolidated financial statements filed with the Commission on Forms 10-K and 10-Q. As a result, Molex filed misstated financial statements throughout the duration of the scheme. Molex's periodic reports lacked any disclosure of Fusamae's unauthorized activities, their effect on Molex's financial position, or of Fusamae's scheme generally.

12. On August 3, 2010, after learning of Fusamae's scheme, Molex recorded cumulative net losses of $201.9 million and restated its fiscal 2008 and 2009 consolidated financial statements as well as the results for the first three quarters of fiscal 2010. The after tax effect of these charges was approximately $128.7 million, which reduced Molex's total stockholder equity by approximately 6% as of June 30, 2010. Molex recognized these losses primarily as a charge to 2008 retained earnings for the losses that pre-dated 2008. For the restated years, Molex recognized losses of $4.7 million in 2008, $2.7 million in 2009, and $26.9 million in 2010 relating to Fusamae's scheme.

Molex's Failure to Make and Keep Accurate Books and Records

13. From at least 1989 to 2010, Molex failed to make and keep accurate books and records reflecting all of Molex Japan's financial transactions, which ultimately resulted in Molex misstating its financial position during this period. In particular, Molex Japan never recorded its trading losses in its accounting records, nor did it record the borrowings in its accounting records.

14. Fusamae took actions to ensure that Molex Japan's accounting records never reflected his unauthorized activities. For example, Fusamae recorded unauthorized loans in dormant Molex Japan general ledger accounts that were no longer in use and had no current legitimate activity. Molex and Molex Japan failed to capture the activity in these dormant accounts

in their financial statements, and therefore their accounting books and records did not accurately capture Molex Japan's financial position.

15. Molex Japan also had no records of account reconciliations for the unauthorized accounts at any time, and also had no records of reconciliations for authorized accounts for the period late 2009 through April 2010. While Molex Japan had records of bank reconciliations on authorized accounts between 2006 and late 2009, these records were at times incomplete. In addition, at certain times, Fusamae created false reconciliations for internal and external auditors that disguised the unauthorized loans as legitimate business activity.

Molex's Internal Control Failures

16. Fusamae's scheme went undetected for more than twenty years due in part to Molex's failure to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions for all of its consolidated entities were authorized and properly recorded and that access to its consolidated companies' assets was permitted only in accordance with management's authorization.

17. For example, Molex Japan lacked adequate internal controls relating to the use of its official corporate seal (also called a "chop"). In Japan, companies use corporate seals to stamp documents to signify that the company has authorized a particular transaction. Throughout Fusamae's scheme, Molex Japan's human resources director controlled the company seal. Additionally, Fusamae was an "acting approver" of the use of the seal when the human resources director was unavailable. At Fusamae's request, the human resources director, who had no knowledge of Molex Japan's banking relationships or borrowings, stamped numerous bank documents with the Molex Japan seal without reading or understanding the documents or confirming that the banking transactions were properly authorized.

18. From 1996 to at least 2010, Fusamae used the Molex Japan seal to take out numerous loans in Molex Japan's name from five different Japanese banks, with no controls in place to provide reasonable assurances that the loans were authorized or properly recorded in Molex Japan's books and records. In his confession letter, Fusamae explained: "Many big companies use dedicated seal for bank transaction, different from the company's official seal, and it is controlled by the person who fully understand the bank transaction. In my case, I could use the bank seal freely and I made all the transactions on my own judgment."

19. Molex Japan also lacked sufficient internal controls to protect the company's assets, including the title deeds for the company's real estate. Molex Japan kept the title deeds for its real estate in a safe in its accounting department. The accounting department employees unlocked the safe every morning so they could remove petty cash stored in the safe. The safe door remained open all day and the accounting department employees locked it again at the close of the business day. Fusamae's desk was in the accounting department and therefore each day he had unfettered access to the unlocked safe and the real estate deeds stored inside it. On several occasions, Fusamae removed the real estate deeds for Molex Japan's manufacturing facilities

from the safe and pledged them as security for some of the unauthorized and undisclosed loans. Fusamae's ability to access and pledge company title deeds without any security measures in place to prevent removal and misuse of those deeds enabled him to borrow a far greater amount than otherwise, and to continue his scheme.

20. Molex Japan also had inadequate internal controls relating to the division of labor in the accounting department, and Fusamae was able to conceal his unauthorized trading and borrowing by monopolizing the flow of information from the banks and broker-dealers where Molex Japan had accounts. During the entirety of his scheme, Fusamae was the sole contact with the banks and broker-dealers where Molex Japan had accounts, and Molex Japan allowed Fusamae to be the sole recipient of the bank and brokerage records for all of Molex Japan's accounts. As a result, no one in Molex Japan's accounting department was in a position to notice the trading losses or unauthorized borrowings.

21. Fusamae was also able to take sole control over the account reconciliation process. Account reconciliations were supposed to be prepared by another member of Molex Japan's accounting department, subject to Fusamae's review and approval. In practice, however, Fusamae took over the reconciliation responsibilities and either did not prepare them or prepared false reconciliations when required. Since the reconciliation process did not involve any other individuals, no one detected the irregularities in Molex Japan's accounts. Fusamae was permitted to dominate all aspects of these accounting processes for multiple years, and Molex Japan did not take any steps to ensure that others were involved as a check on Fusamae.

22. In addition, Molex Japan lacked internal controls designed to prevent employees from accessing closed or dormant general ledger accounts, or to provide reasonable assurances that any activity in such accounts was reflected in Molex Japan's financial statements. Throughout Fusamae's scheme, Molex Japan had in its general ledger a number of bank-related accounts that had no current authorized function. Fusamae used the dormant general ledger accounts to "park" the proceeds from unauthorized loans until he could transfer the funds to other accounts to cover up his trading losses or to balance out other accounts. Molex Japan neglected to perform reviews of any dormant general ledger accounts to confirm there was no activity in them and had no processes in place to provide reasonable assurances that any activity in those accounts was captured in the financial statements. As a result, Molex and Molex Japan failed to detect that Fusamae was using the dormant general ledger accounts to conceal his unauthorized activities and to replenish Molex Japan's active accounts as needed.

23. Finally, Molex's internal audit function was ineffective and failed to perform its responsibilities with respect to Molex Japan. At several points during the scheme, Fusamae was able to manipulate the internal auditors in Japan to either ignore incomplete accounting records such as missing account reconciliations, or to rely on documents prepared by Fusamae without independent verification from other sources.

Violations

24. As a result of the conduct described above, Molex violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13, and 12b-20 thereunder, which require every issuer of a security registered under Section 12 of the Exchange Act to file with the Commission accurate annual and quarterly reports, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

25. Also as a result of the conduct described above, Molex violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

26. Lastly, as a result of the conduct described above, Molex violated Sections 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

Molex's Remedial Efforts

27. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

28. Since 2010, Molex and Molex Japan have taken numerous steps in an effort to improve the companies' internal controls. For example, Molex Japan now has two company seals: one for banking transactions and one for all other transactions. Further, instead of having a human resources employee control the company seals, Molex Japan's seals are now controlled by a member the Molex legal department who reports directly to Molex's General Counsel, who is also a member of the Molex global management team with an understanding of the company's finances and banking needs.

29. Molex has also implemented new procedures with respect to the company's bank account reconciliation process and management of general ledgers. In particular, Molex's internal audit department has developed a continuous monitoring process for account reconciliations globally, which allows corporate finance and internal audit to access electronic copies of the reconciliations completed on a monthly basis. The electronic account reconciliations include supporting documentation that is available for review by Molex Japan's management, Molex's internal audit team, corporate finance management, and Molex's outside auditors. Molex and its subsidiaries are now required by corporate policy to create monthly account reconciliations and maintain those reconciliations in the accounting records. Molex has also closed or otherwise restricted employee access to old, unused, or dormant general ledger accounts.

30. To address what Molex determined to be a problematic culture of deference to superiors at Molex Japan, Molex terminated Fusamae and Molex Japan's vice president of finance, who supervised Fusamae during the latter part of the scheme, and transferred Molex's chief accounting officer to Japan to more closely oversee the subsidiary's operations.

IV.

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

Accordingly, it is hereby ORDERED that:

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

By the Commission.

Brent J. Fields
Secretary

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

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74713; File No. SR-OCC-2014-811)

April 10, 2015

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Amendment No. 2 to an Advance Notice Concerning the Monthly Resizing of the Clearing Fund and the Addition of Financial Resources

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled the Payment, Clearing, and Settlement Supervision Act of 2010[1] ("Payment, Clearing and Settlement Supervision Act") and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 ("Exchange Act"),[2] notice is hereby given that on March 4, 2015, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") Amendment no. 2 to the advance notice ("Amendment No. 2") as described in Items I, II and III below, which Items have been prepared by OCC. On December 1, 2014, OCC originally filed the advance notice with the Commission. On December 16, 2014, OCC filed Amendment No.1 to the advance notice ("Amendment No. 1"), which amended and replaced, in its entirety, the advance notice as originally filed on December 1, 2014.[3] Amendment No. 1 to the advance notice was published for comment in the Federal Register on January 26, 2015.[4]

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1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

3 In Amendment No. 1, OCC amended the advance notice to include the Monthly Clearing Fund Sizing Procedure and the Financial Resource Monitoring and Call Procedure as exhibits to the filing, both defined hereinafter, as Exhibit 5A and Exhibit 5B, respectively. OCC has requested confidential treatment for Exhibit 5A, Exhibit 5B, and Exhibit 5C, referred to hereinafter, pursuant to Exchange Act Rule 24b-2.

4 Securities Exchange Act Release No. 74091 (January 20, 2015), 80 FR 4001 (January 26, 2015) (File No. SR-OCC-2014-811). OCC also filed the proposal

The Commission did not receive any comments on Amendment No. 1 to the advance notice. Amendment No. 2 to the advance notice amends and replaces, in its entirety, Amendment No. 1 to the advance notice. The Commission is publishing this notice to solicit comments on Amendment No. 2 from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by OCC in connection with OCC's proposal to establish procedures regarding the monthly resizing of its Clearing Fund and the addition of financial resources through intra-day margin calls and/or an intra-month increase of the Clearing Fund to ensure that it maintains adequate financial resources in the event of a default of a Clearing Member or group of affiliated Clearing Members presenting the largest exposure to OCC.

This Amendment No. 2 to SR-OCC-2014-811 (SR-OCC-2014-811 is hereinafter defined as the "Filing") amends and replaces in its entirety the Filing as originally submitted on December 1, 2014, and amended on December 16, 2014. The purpose of this Amendment No. 2 is to clarify the operation of a Margin Call Event in the period of time between the calculation of the next month's Clearing Fund Sizing and the collection of the funds pursuant to the Clearing Fund Sizing. Specifically, the amendment clarifies that: (i) funds deposited by a clearing member pursuant to a Margin Call Event are considered in aggregate with other funds remaining on deposit with OCC by the same Clearing Member pursuant to a separate Margin Call Event within the same monthly

contained in the advance notice, and Amendment No. 1 thereto, as a proposed rule change, and subsequent amendment no. 1 thereto, under Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder. See Securities Exchange Act Release No. 73853 (December 16, 2014), 79 FR 76417 (December 22, 2014) (File No. SR-OCC-2014-22). The Commission did not receive any comments on the proposed rule change.

period, as applicable; and (ii) funds deposited by a clearing member pursuant to a Margin Call Event(s) may not be withdrawn until OCC collects all funds to satisfy the next regular monthly Clearing Fund resizing. OCC is also proposing amendments that clarify the definition of "Financial Resources" within the Filing. A restated description of the purpose of the proposed rule change is below. In addition, conforming changes were made to Exhibit 5B, the Financial Resources Monitoring and Call Procedure, which is attached hereto. Further, OCC is proposing to add the Clearing Fund Intra-Month Re-Sizing Procedure, as Exhibit 5C to the Filing, through this Amendment No. 2. The Clearing Fund Intra-Month Re-Sizing Procedure would provide additional clarity regarding the resizing process discussed above.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

The proposed change would establish new procedures regarding the monthly resizing of the Clearing Fund and the addition of financial resources through intra-day margin calls and/or an intra-month increase of the Clearing Fund to ensure that OCC maintains adequate Financial Resources in the event of a default of a Clearing Member or group of affiliated Clearing Members presenting the largest exposure to OCC.

PURPOSE OF THE PROPOSED CHANGE

The proposed change is intended to describe the situations in which OCC would exercise authority under its Rules to ensure that it maintains adequate Financial Resources[5] in the event that stress tests reveal a default of the Clearing Member or Clearing Member Group[6] presenting the largest exposure would threaten the then-current Financial Resources. This proposed change would establish procedures governing: (i) OCC's resizing of the Clearing Fund on a monthly basis pursuant to Rule 1001(a) (the "Monthly Clearing Fund Sizing Procedure"); and (ii) the addition of Financial Resources through an intra-day margin call on one or more Clearing Members under Rule 609 and, if necessary, an intra-month increase of the Clearing Fund pursuant to Rule 1001(a) (the "Financial Resource Monitoring and Call Procedure").[7] The Monthly Clearing Fund Sizing Procedure would permit OCC to determine the size of the Clearing Fund by

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5 "Financial Resources" means, with respect to a projected loss attributable to a particular Clearing Member or Clearing Member Group, as defined below, the sum of the margin deposits (less any excess margin a Clearing Member or Clearing Member Group may have on deposit at OCC) and deposits in lieu of margin in respect of such Clearing Members' or Clearing Member Groups' accounts, and the value of OCC's Clearing Fund, including both the Base Amount, as defined below, and the prudential margin of safety, as discussed below.

6 "Clearing Member Group" means a Clearing Member and any affiliated entities that control, are controlled by or are under common control with such Clearing Member. *See* OCC By-Laws, Article I, Sections 1.C.(15) and 1.M(11).

7 This advance notice filing has also been filed as a proposed rule change (SR-OCC-2014-22).

relying on a broader range of sound risk management practices than those historically used under Rule 1001(a).[8] The Financial Resource Monitoring and Call Procedure would require OCC to collect additional Financial Resources in certain circumstances, establish how OCC calculates and collects such resources and provide the timing by which such resources would be required to be deposited by Clearing Members.

Background

OCC monitors the sufficiency of the Clearing Fund on a daily basis but, prior to emergency action taken on October 15, 2014,[9] OCC had no express authority to increase the size of the Clearing Fund on an intra-month basis.[10] During ordinary course daily monitoring on October 15, 2014, and as a result of increased volatility in the financial markets in October 2014, OCC determined that the Financial Resources needed to cover the potential loss associated with a default of the Clearing Member or Clearing Member

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8 The procedures described herein would be in effect until the development of a new standard Clearing Fund sizing methodology. Following such development, which will include a quantitative approach to calculating the "prudential margin of safety," as discussed below, OCC will file a separate rule change and advance notice with the Commission that will include a description of the new methodology as well as a revised Monthly Clearing Fund Sizing Procedure.

9 On October 16, 2014, OCC filed an emergency notice with the Commission to suspend the effectiveness of the second sentence of Rule 1001(a). *See* Securities Exchange Act Release No. 73579 (November 12, 2014), 79 FR 68747 (November 18, 2014) (SR-OCC-2014-807). On November 13, 2014, OCC filed SR-OCC-2014-21 with the Commission to delete the second sentence of Rule 1001(a), preserving the suspended effectiveness of that sentence until such time as the Commission approves or disapproves SR-OCC-2014-21. *See* Securities Exchange Act Release No. 73685 (November 25, 2014), 79 FR 71479 (December 2, 2014), (SR-OCC-2014-21).

10 *See* OCC Rule 1001(a).

Group presenting the largest exposure could have exceeded the Financial Resources then available to apply to such a default.

To permit OCC to increase the size of its Clearing Fund prior to the next monthly resizing that was scheduled to take place on the first business day of November 2014, OCC's Executive Chairman, on October 15, 2014, exercised certain emergency powers as set forth in Article IX, Section 14 of OCC's By-Laws[11] to waive the effectiveness of the second sentence of Rule 1001(a), which states that OCC will adjust the size of the Clearing Fund monthly and that any resizing will be based on data from the preceding month. OCC then filed an emergency notice with the Commission pursuant to Section 806(e)(2) of the Payment, Clearing and Settlement Supervision Act of 2010[12] and increased the Clearing Fund size for the remainder of October 2014 as otherwise provided for in the first sentence of Rule 1001(a).[13]

Clearing Members were informed of the action taken by the Executive Chairman[14] and the amount of their additional Clearing Fund requirements, which were

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[11] OCC also has submitted an advance notice that would provide greater detail concerning conditions under which OCC would increase the size of the Clearing Fund intra-month. The change would permit an intra-month increase in the event that the five-day rolling average of projected draws are 150% or more of the Clearing Fund's then current size. *See* Securities Exchange Act Release No. 72804 (August 11, 2014), 79 FR 48276 (August 15, 2014) (SR-OCC-2014-804).

[12] 12 U.S.C. 5465(e)(2).

[13] *See supra*, note 10.

[14] *See* Information Memorandum #35397, dated October 16, 2014, available on OCC's website, http://www.theocc.com/clearing/clearing-infomemos/infomemos1.jsp. Clearing members also were informed that a prudential margin of safety of $1.8 billion would be retained until a new Clearing Fund sizing formula has been approved and implemented.

met without incident. As a result of these actions, OCC's Clearing Fund for October 2014 was increased by $1.8 billion. In continued reliance on the emergency rule waiver and in accordance with the first sentence of Rule 1001(a), OCC set the November 2014 Clearing Fund size at $7.8 billion, which included an amount determined by OCC to be sufficient to protect OCC against loss under simulated default scenarios (*i.e.*, $6 billion), plus a prudential margin of safety (the additional $1.8 billion collected in October).[15] All required contributions to the November 2014 Clearing Fund were met by affected Clearing Members.

Under Article IX, Section 14(c), absent the submission of a proposed rule change to the Commission seeking approval of OCC's waiver of the provisions of the second sentence of Rule 1001(a), such waiver would not be permitted to continue for more than thirty calendar days from the date thereof.[16] Accordingly, on November 13, 2014, OCC submitted SR-OCC-2014-21 to delete the second sentence of Rule 1001(a) and, by the terms of Article IX, Section 14(c), preserve the suspended effectiveness of the second sentence of Rule 1001(a) beyond thirty calendar days.[17]

SR-OCC-2014-21 was submitted in part to permit OCC to determine the size of its Clearing Fund by relying on a broader range of sound risk management practices than considered in basing such size on the average daily calculations under Rule 1001(a) that

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15 *See* Information Memorandum # 35507, dated October 31, 2014, available on OCC's website, http://www.theocc.com/clearing/clearing-infomemos/infomemos1.jsp.

16 *See* OCC By-Laws, Article IX, Section 14(c).

17 *See supra*, note 10. OCC also submitted this proposed rule change to the Commodity Futures Trading Commission.

are performed during the preceding calendar month. The Monthly Clearing Fund Sizing Procedure, as described below, is based on such broader risk management practices and establishes the procedures OCC would use to determine the size of the Clearing Fund on a monthly basis. Similarly, SR-OCC-2014-21 was submitted in part to permit OCC to resize the Clearing Fund more frequently than monthly when the circumstances warrant an increase of the Clearing Fund. The Financial Resource Monitoring and Call Procedure, as described below, establishes the procedures that OCC would use to add Financial Resources through an intra-day margin call on one or more Clearing Members under Rule 609 and, if necessary, an intra-month increase of the Clearing Fund pursuant to Rule 1001(a).[18]

Monthly Clearing Fund Sizing Procedure

Under the Monthly Clearing Fund Sizing Procedure, OCC would continue to calculate the size of the Clearing Fund based on its daily stress test exposures under simulated default scenarios as described in the first sentence of Rule 1001(a) and resize the Clearing Fund on the first business day of each month. However, instead of resizing the Clearing Fund based on the average of the daily calculations during the preceding calendar month, as stated in the suspended second sentence of Rule 1001, OCC would resize the Clearing Fund so that it is the sum of: (i) an amount equal to the peak five-day rolling average of Clearing Fund draws observed over the preceding three calendar months of daily idiosyncratic default and minor systemic default scenario calculations

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[18] As noted in SR-OCC-2014-21, OCC would use its intra-month resizing authority only to increase the size of the Clearing Fund where appropriate, not to decrease the size of the Clearing Fund.

based on OCC's daily Monte Carlo simulations ("Base Amount") and (ii) a prudential margin of safety determined by OCC and currently set at $1.8 billion.[19]

OCC believes that the proposed Monthly Clearing Fund Sizing Procedure provides a sound and prudent approach to ensure that the Financial Resources are adequate to protect against the largest risk of loss presented by the default of a Clearing Member or Clearing Member Group. By virtue of using only the peak five-day rolling average and by extending the look-back period, the proposed Monthly Clearing Fund Sizing Procedure is both more responsive to sudden increases in exposure and less susceptible to recently observed decreases in exposure that would reduce the overall sizing of the Clearing Fund, thus mitigating procyclicality.[20] Furthermore, the prudential margin of safety provides an additional buffer to absorb potential future exposures not previously observed during the look-back period. The proposed Monthly Clearing Fund Sizing Procedure would be supplemented by the Financial Resource Monitoring and Call Procedure, described below, to provide further assurance that the Financial Resources are adequate to protect against such risk of loss.

19 On a daily basis, OCC computes its exposure under the idiosyncratic and minor systemic events. The greater of these two exposures is that day's "peak exposure." To calculate the "rolling five day average" OCC computes the average of the peak exposure for each consecutive five-day period observed over the prior three-month period. To determine the Base Amount, OCC would use the largest five-day rolling average observed over the past three-months. This methodology was used to determine the Base Amount of the Clearing Fund for November 2014 and December 2014.

20 Considering only the peak exposures is a more conservative methodology that gives greater weighting to sudden increases in exposure experienced by Clearing Members, thus enhancing the responsiveness of the procedure to such sudden increases. By using a longer look-back period, the methodology would respond more slowly to recently observed decreases in peak exposures.

Financial Resource Monitoring and Call Procedure

Under the Financial Resource Monitoring and Call Procedure, OCC would use the same daily idiosyncratic default calculation as under the Monthly Clearing Fund Sizing Procedure to monitor daily the adequacy of the Financial Resources to withstand a default by the Clearing Member or Clearing Member Group presenting the largest exposure under extreme but plausible market conditions.[21] If such a daily idiosyncratic default calculation projected a draw on the Clearing Fund (a "Projected Draw") that is at least 75% of the Clearing Fund maintained by OCC, OCC would be required to issue an intra-day margin call pursuant to Rule 609 against the Clearing Member or Clearing Member Group that caused such a draw ("Margin Call Event").[22] Subject to a limitation described below, the amount of the margin call would be the difference between the Projected Draw and the Base Clearing Fund ("Exceedance Above Base Amount"). In the case of a Clearing Member Group that causes the Exceedance Above Base Amount, the Exceedance Above Base Amount would be pro-rated among the individual Clearing Members that compose the Clearing Member Group based on each individual Clearing

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21 Since the minor systemic default scenario contemplates two Clearing Members' simultaneously defaulting and OCC maintains Financial Resources sufficient to cover a default by a Clearing Member or Clearing Member Group representing the greatest exposure to OCC, OCC does not use the minor systemic default scenario to determine the adequacy of the Financial Resources under the Financial Resource Monitoring and Call Procedure.

22 Rule 609 authorizes OCC to require the deposit of additional margin in any account at any time during any business day by any Clearing Member for, *inter alia*, the protection of OCC, other Clearing Members or the general public. Clearing Members must meet a required deposit of intra-day margin in immediately available funds at a time prescribed by OCC or within one hour of OCC's issuance of debit settlement instructions against the bank account(s) of the applicable Clearing Member(s), thereby ensuring the prompt deposit of additional Financial Resources.

Member's proportionate share of the "total risk" for such Clearing Member Group as defined in Rule 1001(b), i.e., the margin requirement with respect to all accounts of the Clearing Member Group exclusive of the net asset value of the positions in such accounts aggregated across all such accounts. However, in the case of an individual Clearing Member or a Clearing Member Group, the margin call would be subject to a limitation under which it could not exceed the lower[23] of: (a) $500 million, or (b) 100% of a Clearing Member's net capital. Such limitation would be measured in aggregate with any funds remaining on deposit with OCC deposited by the same Clearing Member pursuant to a Margin Call Event within the same monthly period, as applicable, until collection of all funds to satisfy the next regular monthly Clearing Fund resizing (the "500/100 Limitation").[24]

Upon satisfaction of the margin call, OCC would use its authority under Rule 608 to preclude the withdrawal of such additional margin amount until it collects all of the funds determined by the next Monthly Clearing Fund Sizing Procedure. Based on three years of back testing data, OCC determined that it would have had Margin Call Events in 10 of the months during this time period. For each of these months, the maximum call

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23 "Capping" the intra-day margin call avoids placing a "liquidity squeeze" on the subject Clearing Member(s) based on exposures presented by a hypothetical stress test, which would have the potential for causing a default on the intra-day margin call. Back testing results determined that such calls would have been made against Clearing Members that are large, well-capitalized firms, with more than sufficient resources to satisfy the call for additional margin with the proposed limitations.

24 The Risk Committee would be notified, and could take action to address potential Financial Resource deficiencies, in the event that a Projected Draw resulted in a Margin Call Event and as a result of the 500/100 Limitation the margin call was less than the Exceedance Above Base Amount, but the Projected Draw was not so large as to result in an increase in the Clearing Fund as discussed below.

amount would have been equal to $500 million, with one exception in which the maximum call amount for the month was $7.7 million.[25] After giving effect to the intra-day margin calls, *i.e.*, by increasing the Financial Resources by $500 million, there was only one Margin Call Event where there was an observed stress test exceedance of the Financial Resources.

To address this one observed instance, the Financial Resource Monitoring and Call Procedure also would require OCC to increase the size of the Clearing Fund ("Clearing Fund Intra-month Increase Event") if a Projected Draw exceeds 90% of the Clearing Fund, after applying any funds then on deposit with OCC from the applicable Clearing Member or Clearing Member Group pursuant to a Margin Call Event. The amount of such increase ("Clearing Fund Increase") would be the greater of: (a) $1 billion; or (b) 125% of the difference between (i) the Projected Draw, as reduced by the deposits resulting from the Margin Call Event and (ii) the Clearing Fund. Each Clearing Member's proportionate share of the Clearing Fund Increase would equal its proportionate share of the variable portion of the Clearing Fund for the month in question as calculated pursuant to Rule 1001(b). OCC would notify the Risk Committee of the Board of Directors (the "Risk Committee"), Clearing Members and appropriate regulatory authorities of the Clearing Fund Increase on the business day on which the Clearing Fund Intra-month Increase Event occurred. This ensures that OCC management maintains authority to address any potential Financial Resource deficiencies when compared to its Projected Draw estimates. The Risk Committee would then determine whether the Clearing Fund Increase was sufficient, and would retain authority to increase

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[25] The back testing analysis performed assumed a single Clearing Member caused the exceedance.

the Clearing Fund Increase or the margin call made pursuant to a Margin Call Event in its discretion. Clearing Members would be required to meet the call for additional Clearing Fund assets by 9:00 AM CT on the second business day following the Clearing Fund Intra-Month Increase Event. OCC believes that this collection process ensures additional Clearing Fund assets are promptly deposited by Clearing Members following notice of a Clearing Fund Increase, while also providing Clearing Members with a reasonable period of time to source such assets. Based on OCC's back testing results, after giving effect to the intra-day margin call in response to a Margin Call Event plus the prudential margin of safety, the Financial Resources would have been sufficient upon implementing the one instance of a Clearing Fund Intra-month Increase Event.

OCC believes the Financial Resource Monitoring and Call Procedure strikes a prudent balance between mutualizing the burden of requiring additional Financial Resources and requiring the Clearing Member or Clearing Member Group causing the increased exposure to bear such burden. As noted above, in the event of a Margin Call Event, OCC limits the margin call until collection of all funds to satisfy the next regular monthly resizing to an aggregate of $500 million, or 100% of a Clearing Member's net capital in order to avoid putting an undue liquidity strain on any one Clearing Member. However, where a Projected Draw exceeds 90% of OCC's Clearing Fund, OCC must act to ensure that it has sufficient Financial Resources, and determined that it should mutualize the burden of the additional Financial Resources at this threshold through a Clearing Fund Increase. OCC believes that this balance would provide OCC with sufficient Financial Resources without increasing the likelihood that its procedures would, based solely on stress testing results, cause a liquidity strain on any on Clearing Member that could result in such member's default.

The following examples illustrate the manner in which the Financial Resource Monitoring and Call Procedure would be applied. All assume that the Clearing Fund size is $7.8 billion, $6 billion of which is the Base Amount and $1.8 billion of which is the prudential margin of safety. The 75% threshold in these examples is $5.85 billion.

Example 1: Single CM

Under OCC's stress testing the Projected Draw attributable to Clearing Member ABC, a Clearing Member with no affiliated Clearing Members and net capital of $500 million, is $6.4 billion, or 82% of the Clearing Fund. OCC would make a margin call for $400 million, which represents the Exceedance Above Base Amount. In this case the 500/100 Limitation would not be applicable because the Exceedance Above Base Amount is less than $500 million and 100% of the Clearing Member's net capital. The Clearing Member would be required to meet the $400 million call within one hour unless OCC prescribed a different time, and OCC would retain the $400 million until collection of all the funds to satisfy the next monthly Clearing Fund sizing calculation.

If, on a different day within the same month, CM ABC's Projected Draw minus the $400 million already deposited with OCC results in an Exceedance above Base Amount, another Margin Call Event would be triggered, with the amount currently deposited with OCC applying toward the 500/100 Limitation.

Example 2: Clearing Member Group

Under OCC's stress testing the Projected Draw attributable to Clearing Member Group DEF, comprised of two Clearing Members each with net capital of $800 million, is \$6.2 billion, or 79% of OCC's Clearing Fund. OCC would initiate a margin call on Clearing Member Group DEF for \$200 million. The call would be allocated to the two Clearing Members that compose the Clearing Member Group based on each Clearing Member's risk margin allocation. In this case the 500/100 Limitation would not be applicable because the Exceedance Above Base Amount is less than \$500 million and 100% of net capital. The margin call would be required to be met within one hour of the call unless OCC prescribed a different time. For example, in the case where one Clearing Member accounts for 75% of the risk margin for the Clearing Member Group, that Clearing Member would be allocated \$150 million of the call and the other Clearing Member, accounting for 25% of the risk margin for the Clearing Member Group, would be allocated \$50 million of the call. The funds would remain deposited with OCC until collection of all the funds to satisfy the next monthly Clearing Fund sizing calculation.

Example 3: Clearing Member Group with \$500 million cap

Under OCC's stress testing the Projected Draw attributable to Clearing Member Group GHI, comprised of two Clearing Members each with net capital of \$800 million, is \$6.8 billion, or 87% of the Clearing Fund. The Exceedance Above Base Amount would be \$800 million, allocated to the two Clearing Members that compose the Clearing Member Group based on each Clearing Member's risk margin allocation. Using the 75/25 risk margin allocation from Example 2, one Clearing Member would be allocated \$600 million and the other Clearing Member would be allocated \$200 million. The first Clearing Member would be required to deposit \$500 million with OCC, which is the lowest of \$500 million, that member's net capital, or that member's share of the Exceedance Above Base Amount, and the other Clearing Member would be required to deposit $200 million with OCC. After collecting the additional margin, OCC would determine whether the Projected Draw would exceed 90% of the Clearing Fund after reducing the Projected Draw by the additional margin. This calculation would divide a Projected Draw of $6.1 billion, which is the original Projected Draw of $6.8 billion reduced by the additional margin, by the Clearing Fund of $7.8 billion. The resulting percentage of 78% would be below the 90% threshold, and accordingly there would not be a Clearing Fund Intra-month Increase Event.

Example 4: Margin Call and Increase in Size of Clearing Fund

Under OCC's stress testing the Projected Draw attributable to Clearing Member JKL, a Clearing Member with no affiliated Clearing Members and net capital of $600 million, is $10.0 billion, or 128% of the Clearing Fund. OCC would make a margin call for $500 million, which represents the lowest of the Exceedance Above Base Amount, $500 million and 100% of net capital. The Clearing Member would be required to meet the $500 million call within one hour unless OCC prescribed a different time, and OCC would retain the $500 million until collection of all the funds to satisfy the next monthly Clearing Fund sizing calculation. After collecting the additional margin, OCC would determine whether the Projected Draw would exceed 90% of the Clearing Fund after reducing the Projected Draw by the additional margin. This calculation would divide a Projected Draw of $9.5 billion, which is the original Projected Draw of $10 billion reduced by the additional margin, by the Clearing Fund of $7.8 billion. The resulting percentage of 122%, while lower, would still exceed the 90% threshold, and accordingly OCC would declare a Clearing Fund Intra-month Increase Event. To calculate the Clearing Fund Increase, OCC would first determine the difference between the modified

Projected Draw ($9.5 billion) and the Clearing Fund ($7.8 billion), which in this case would be $1.7 billion, OCC would then multiply this by 1.25, resulting in $2.125 billion. Because this amount is greater than $1 billion, the Clearing Fund Increase would be $2.125 billion and a modified Clearing Fund of OCC totaling $9.925 billion ($425 million in excess of the modified Projected Draw of $9.5 billion).

CONSISTENCY WITH THE PAYMENT, CLEARING AND SETTLEMENT SUPERVISION ACT

OCC believes that the proposed change regarding the establishment of the Monthly Clearing Fund Sizing Procedure and Financial Resource Monitoring and Call Procedure described above is consistent with Section 805(b)(1) of the Payment, Clearing and Settlement Supervision Act[26] because the proposed procedures will promote robust risk management by setting forth a process in order to ensure that OCC maintains adequate Financial Resources in the event of a default of a Clearing Member or Clearing Member Group presenting the largest exposure to OCC. The proposed change regarding the establishment of these procedures is also consistent with Section 806(e)(2) of the Payment, Clearing and Settlement Supervision Act, upon which OCC relied in originally suspending the effectiveness of the second sentence of Rule 1001(a) and increasing the size of the Clearing Fund on October 15, 2014, because it allows OCC to continue to provide its services in a safe and sound manner.[27]

ANTICIPATED EFFECT ON AND MANAGEMENT OF RISK

OCC believes that the proposed change will reduce OCC's overall level of risk because the proposed change makes it less likely that OCC's Clearing Fund would be

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[26] 12 U.S.C. 5464(b)(1).

[27] 12 U.S.C. 5464(e)(2); *see* SR-OCC-2014-807, *supra*, note 8.

insufficient should OCC need to use its Clearing Fund to manage a Clearing Member or Clearing Member Group default. The Monthly Clearing Fund Sizing Procedure would permit OCC to determine the size of its Clearing Fund by relying on a broader range of sound risk management practices than those considered in the suspended second sentence of Rule 1001(a). OCC believes that using the peak five-day rolling average of Clearing Fund draws observed over a three-month period will result in a monthly resizing of the Clearing Fund that will better reflect the risks posed by sudden increases in exposure experienced by Clearing Members. OCC also believes that the proposed prudential margin of safety will provide an additional buffer to protect against exposures not reflected in the three-month look-back period. The Financial Resource Monitoring and Call Procedure would enable OCC to minimize losses in the event of a default of a Clearing Member or Clearing Member Group presenting the largest exposure to OCC, by allowing it the flexibility to obtain additional Financial Resources either through an intra-day margin call or an intra-month increase in the size of the Clearing Fund, which would ensure that the clearance and settlement of transactions in options and other contracts occurs without interruption. Accordingly, OCC believes that the proposed changes would reduce risks to OCC and its participants. Moreover, and for the same reasons, the proposed change will facilitate OCC's ability to manage risk.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The advance notice may be implemented if the Commission does not object to the advance notice within 60 days of the later of (i) the date that the advance notice was filed with the Commission or (ii) the date that any additional information requested by the

Commission is received. OCC shall not implement the advance notice if the Commission has any objection to the advance notice.

The Commission may extend the period for review by an additional 60 days if the advance notice raises novel or complex issues, subject to the Commission providing OCC with prompt written notice of the extension. An advance notice may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies OCC in writing that it does not object to the advance notice and authorizes OCC to implement the advance notice on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2014-811 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2014-811. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_811.pdf.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2014-811 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Brent J. Fields
Secretary

Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74711 / April 10, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16486

In the Matter of WILLIAM F. FANG, 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 William F. Fang ("Fang" 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 paragraph III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Fang, 31 years old, is a resident of New York, New York. From March 2008 to July 2011, Fang was an investment banking associate and registered representative associated with Macquarie Capital (USA) Inc. ("Macquarie"), a registered broker-dealer with principal offices in New York, New York. During this time, Fang held Series 17 and 63 licenses.

2. On March 27, 2015, the Commission filed a civil action against Fang in the United States District Court for the Southern District of New York, Securities and Exchange Commission v. Macquarie Capital (USA) Inc., et al., Civil Action No. 1:15-cv-02304. The Commission's complaint alleges, inter alia, that Fang, while employed at Macquarie, violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 ("Securities Act") in connection with his participation in Macquarie's underwriting of Puda Coal Inc.'s December 2010 public stock offering.

3. On April 1, 2015, the United States District Court for the Southern District of New York entered a final judgment by consent against Fang in the above civil action permanently enjoining him from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

IV.

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

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

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

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

C. With the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74710 / April 10, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16485

In the Matter of **AARON BLACK,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Aaron Black ("Black" 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 paragraph III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Black, age 40, resides in New South Wales, Australia. He is currently a Division Director in the Sydney office of Macquarie Group Limited, a global financial services firm headquartered in Australia. Black has worked with Macquarie Group Limited or its affiliates in different capacities since 2003. From November 2008 to December 2011, Black was a managing director at Macquarie Capital (USA) Inc. ("Macquarie") in its New York City office and was a registered representative with Series 7, 24 and 63 licenses. Macquarie is a wholly owned subsidiary of Macquarie Group Limited and has been registered with the Commission as a broker-dealer since 1994.

2. On March 27, 2015, the Commission filed a civil action against Black in the United States District Court for the Southern District of New York, Securities and Exchange Commission v. Macquarie Capital (USA) Inc., et al., Civil Action No. 1:15-cv-02304. The Commission's complaint alleges, inter alia, that Black, while employed at Macquarie, violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 ("Securities Act") in connection with his participation in Macquarie's underwriting of Puda Coal Inc.'s December 2010 public stock offering.

3. On April 1, 2015, the United States District Court for the Southern District of New York entered a final judgment by consent against Black in the above civil action permanently enjoining him from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

IV.

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

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

A. Barred from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

B. With the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74720 / April 13, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16487

In the Matter of A Better Way Financial Corp., Atrisco Oil & Gas LLC, Beach Brew Beverage Company, Inc., Belenus Acquisition Corp., Bennett-Reed, Inc., BF Acquisition Group IV, Inc., and Big Bear Gold 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 A Better Way Financial Corp., Atrisco Oil & Gas LLC, Beach Brew Beverage Company, Inc., Belenus Acquisition Corp., Bennett-Reed, Inc., BF Acquisition Group IV, Inc., and Big Bear Gold Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. A Better Way Financial Corp. (CIK No. 1101914) is a dissolved Wyoming corporation located in Tucson, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). A Better Way is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a

Form 10-QSB for the period ended March 31, 2005, which reported a net loss of $12,906 from the company's October 20, 1999 inception to March 31, 2010.

2. Atrisco Oil & Gas LLC (CIK No. 1376992) is a New Mexico corporation located in Albuquerque, New Mexico with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Atrisco Oil & Gas LLC is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2009, which reported a net loss of $86,666 for the prior three months.

3. Beach Brew Beverage Company, Inc. (CIK No. 1123315) is a permanently revoked Nevada corporation located in Encinitas, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Beach Brew is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on November 3, 2000, which reported a net loss of $135,351 from the company's October 30, 1997 inception to September 30, 2000.

4. Belenus Acquisition Corp. (CIK No. 1491827) is a forfeited Delaware corporation located in Alhambra, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Belenus is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on September 16, 2010, which reported a net loss of $3,139 from the company's August 12, 2010 inception to August 31, 2010.

5. Bennett-Reed, Inc. (CIK No. 1108705) is a permanently revoked Nevada corporation located in Fountain Hills, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bennett Reed is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of $3,900 from the company's February 25, 1998 inception to September 30, 2001.

6. BF Acquisition Group IV, Inc. (CIK No. 1089777) is an inactive Florida corporation located in San Francisco, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BF Acquisition Group IV is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended January 31, 2005, which reported a net loss of $38,419 for the prior nine months.

7. Big Bear Gold Corp. (CIK No. 1108731) is a forfeited Delaware corporation located in Surrey, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Bear Gold is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended November 30, 2004, which reported a net loss of $102,162 for the prior nine months.

B. DELINQUENT PERIODIC FILINGS

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

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

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

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74721 / April 13, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16488

In the Matter of **Aryeh Acquisition Corp.,** **Bedminster Capital Corp.,** **Bedminster Financial Corp., and** **Bellows Acquisition 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 Aryeh Acquisition Corp., Bedminster Capital Corp., Bedminster Financial Corp., and Bellows Acquisition Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Aryeh Acquisition Corp. (CIK No. 1417367) is a void Delaware corporation located in Lawrence, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aryeh Acquisition 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 September 30, 2008, which reported a net loss of $22,154 for the prior twelve months.

2. Bedminster Capital Corp. (CIK No. 1401093) is a revoked Nevada corporation located in Bedminster, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bedminster Capital is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $361,433 for the prior nine months.

3. Bedminster Financial Corp. (CIK No. 1401094) is a revoked Nevada corporation located in Bedminster, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bedminster Financial is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $283,792 for the prior nine months.

4. Bellows Acquisition Corp. (CIK No. 1122107) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bellows Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2008, which reported a net loss of $6,960 for the prior nine months.

B. DELINQUENT PERIODIC FILINGS

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

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

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 232

[Release Nos. 33-9746; 34-74714; 39-2502; IC-31551]

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 updates are being made primarily to support the 2015 US GAAP financial reporting and 2015 EXCH taxonomies; add new form types for registration of Security-based swap data repositories (SDR); revise the Form ID Application Confirmation screen; remove references to the Paper Form ID; and revise Item 1 on submission form type MA-A. The EDGAR system was upgraded to support the new 2015 taxonomies and revised MA-A form functionalities on March 9, 2015. The EDGAR system is scheduled to be upgraded to support the other functionalities on April 13, 2015.

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 Trading and Markets, for questions concerning Form SDR and the revisions for Form MA-A, contact Kathy Bateman at (202) 551-4345, and in the Office of Information Technology, contact Tammy Borkowski at (202) 551-7208.

SUPPLEMENTARY INFORMATION: We are adopting an updated EDGAR Filer Manual, Volume I and Volume II. The Filer Manual describes the technical formatting requirements for

the preparation and submission of electronic filings through the EDGAR system.[1] It also describes the requirements for filing using EDGARLink Online and the Online Forms/XML website.

The revisions to the Filer Manual reflect changes within Volume I entitled EDGAR Filer Manual, Volume I: "General Information," Version 20 (April 2015), and Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 30 (April 2015). 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 15.1 on April 13, 2015 and will introduce the following changes:

EDGAR will be updated to add new submission form types SDR, SDR/A, SDR-A, and SDR-W. These submission form types can be accessed by selecting the "File SDR" link on the EDGAR Filing Website. Additionally, applicants may construct XML submissions for these submission types by following the "EDGAR SDR XML Technical Specification" document available on the SEC's Public Website (*http://www.sec.gov/info/edgar.shtml*).

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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 December 15, 2014. See Release No. 33-9692 (December 23, 2014) [79 FR 76878].

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

[3] See Release No. 33-9692 in which we implemented EDGAR Release 14.3. For additional history of Filer Manual rules, please see the cites therein.

Submission form types SDR, SDR/A, SDR-A, and SDR-W will include the "Request Confidentiality" check box to allow applicants to select which information to request confidential treatment. After a Form SDR is submitted, SEC staff will review the submission and make a determination of whether the information for which confidential treatment is requested should be made public. EDGAR will disseminate only the content and attached exhibits of the submission that the SEC staff has determined to be public.

The "Form ID Application Confirmation" screen will display four additional labels: "Signature of Authorized Person," "Printed Name of Signature," "Title of Person Signing," and "Notary Signature & Seal to be Placed Here." This screen will also be updated to include a "Print Window" button to print the completed online Form ID application. The printed application can be signed and notarized by the filer to serve as the authentication document when applying for EDGAR access.

All references to the Paper Form ID have been removed from the Filer Manual. Filers can print the electronic Form ID and use this as the authentication document as explained above.

EDGAR was updated to support the 2015 US GAAP financial reporting taxonomy and the 2015 EXCH taxonomy. A complete listing of supported standard taxonomies is available on http://www.sec.gov/info/edgar/edgartaxonomies.shtml.

Item 1 "Identifying Information" on submission type MA-A was updated for the following question: "Changes: Are there any changes in this annual update to information provided in the municipal advisor's most recent Form MA, other than the updated Execution Page?" If filers select "No" as a response to the question, then all fields will be disabled on submission type MA-A with the exception of "Execution" and "Filer Information" tabs and the "Fiscal Year End Information" field on Item 1. Alternatively, if filers select "Yes" to the question, then they must update applicable items on submission type MA-A.

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.

The updated EDGAR Filer Manual will be available for website viewing and printing; the address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. You may also 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, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

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 15.1 is scheduled to become available on April 13, 2015. 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.

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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).

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.

TEXT OF THE AMENDMENT

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

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

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

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

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2. Section 232.301 is revised to read as follows:

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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.

§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 20 (April 2015). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 30 (April 2015). Additional provisions applicable to Form N-SAR filers are set forth in the EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 4 (October 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. The EDGAR Filer Manual is available for Web site viewing and printing; the address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. 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, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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.

Brent J. Fields
Secretary

April 13, 2015

Commissioner Aguilar Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74735 / April 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16268

In the Matter of ROBERT C. WEAVER, JR., Esq., Respondent.	ORDER MAKING FINDINGS AND IMPOSING A REMEDIAL SANCTION PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE

I.

On November 12, 2014, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Rule 102(e) of the Commission's Rules of Practice against Robert C. Weaver, Jr., Esq. ("Weaver" or "Respondent"). Respondent has submitted an Offer of Settlement that the Commission has determined to accept.

II.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Weaver consents to the entry of this Order Making Findings and Imposing a Remedial Sanction Pursuant to Rule 102(e) of the Commission's Rules of Practice ("Order"), as set forth below.

III.

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

1. Robert C. Weaver, Jr. was, at all relevant times, an attorney licensed in the State of California. Between 2006 and 2011, Weaver provided assistance to Thomas Coldicutt and his wife, Elizabeth Coldicutt ("the Coldicutts") in creating, registering and selling public shell companies putatively engaged in mining operations. Weaver wrote "opinion of legality" letters for registration statements, and served as counsel for three of the companies. As company counsel, Weaver assisted the officers and directors in preparing Commission filings. Weaver also served as the sole officer and director of one of the shell companies, Centaurus Resources Corp. ("Centaurus").

2. On August 13, 2012, the Commission filed a complaint against Weaver in the United States District Court for the Eastern District of Texas – the case was later transferred to the Central District of California – alleging that the shell companies were part of a scheme to commit fraud, and that Weaver assisted the Coldicutts in that scheme by failing to disclose their involvement in filings with the Commission. *SEC v. Thomas D. Coldicutt, Jr., et al.*, Civil Action Number 2:13-cv-01865-RGK-VBK (C.D. Cal.). The Commission further alleged that Weaver made filings with the Commission relating to Centaurus that contained false or misleading statements, including the failure to disclose the Coldicutts' involvement in Centaurus. Based on these allegations, the complaint charged Weaver with violating Sections 17(a)(1), (2) and (3) of the Securities Act, and Section 10(b) of the Exchange Act, and Rules 10b-5(a), (b) and (c) and 15d-14 thereunder; and aiding and abetting violations of Sections 10(b) and 15(d) of the Exchange Act, and Rules 10b-5, 12b-20, 15d-1 and 15d-13 thereunder.

3. On August 14, 2014, the court entered a final judgment against Weaver, which he consented to without admitting or denying the conduct alleged in the complaint. The final judgment permanently enjoined Weaver from future violations of Sections 17(a)(2) and (3) of the Securities Act, and Section 15(d) of the Exchange Act and Rules 12b-20, 15d-1 and 15d-13 thereunder; ordered him to pay disgorgement with prejudgment interest and a fine; and prohibited him from acting as an officer or director or participating in penny stock offerings for five years.

4. On November 12, 2014, the Commission instituted administrative proceedings and imposed a temporary suspension pursuant to Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice against Weaver based upon the judgment that permanently enjoins Weaver from future violations of the federal securities laws.

5. On December 29, 2014, the Commission denied Weaver's petition to lift the temporary suspension and set the matter down for a public hearing.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Rule 102(e) of the Commission's Rules of Practice, effective immediately, that:

A. Weaver is suspended from appearing or practicing before the Commission as an attorney for a term of five years, commencing August 14, 2014, the date of the final judgment issued by the court.

B. After five years from the August 14, 2014 final judgment issued by the court, Weaver 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 the General Counsel.

C. In support of such an application, Weaver must provide a certificate of good standing from each state bar of which he is a member.

D. In support of such an application, Weaver must also submit an affidavit truthfully stating, under penalty of perjury:

1. that he has complied with the Commission's November 12, 2014 Order Imposing Temporary Suspension ("Order"), and with any orders in *SEC v. Thomas D. Coldicutt, Jr., et al.*, Civil Action Number 2:13-cv-01865-RGK-VBK (C.D. Cal.), including the order that requires him to pay disgorgement with prejudgment interest and a fine, and prohibits him from acting as an officer or director or participating in penny stock offerings for five years;

2. that he:

   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. has not, since the entry of the Order, 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 and underlying civil action;

3. that since the entry of the Order, he has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and

4. that since the entry of the Order, he:

   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 and underlying civil action;

   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 and underlying civil action;

   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 underlying civil action; 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 and underlying civil action.

E. If Weaver 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 Weaver is not able to truthfully attest to the statements required in Subparagraphs D(2)(b) or D(4), he 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74737 / April 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16492

In the Matter of OCZ TECHNOLOGY GROUP, INC. (n/k/a ZCO Liquidating Corp.), Respondent.	ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against OCZ Technology Group, Inc. (n/k/a ZCO Liquidating Corp.) ("OCZ" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

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

A. OCZ (CIK 0001355128) is a Delaware corporation based in San Jose, California, which, prior to its bankruptcy filing, was primarily engaged in the business of selling computer memory and power supply products. The common stock of OCZ has been registered under Section 12(g) of the Exchange Act since November 29, 2009. As of April 2010, OCZ's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and listed on the NASDAQ Global Market. OCZ's stock was delisted from NASDAQ as of March 6, 2014, causing OCZ's Section 12(b) registration to be terminated and its Section 12(g) registration to be revived. OCZ's shares are not currently quoted on any market. OCZ filed a Chapter 11 bankruptcy proceeding on December 2, 2013 and its plan of liquidation was confirmed by the U.S. Bankruptcy Court for the District of Delaware on July 30, 2014.

B. OCZ has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, while its common stock was registered with the Commission in that it has not filed an Annual Report on Form 10-K since October 7, 2013 or periodic or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ending August 31, 2013.

IV.

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

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

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

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9749 / April 16, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74750 / April 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16495

In the Matter of

RONALD A. WARREN

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 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 Ronald A. Warren ("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, and except as provided herein in Section V, 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.

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III.

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

Respondent

1. Respondent was the sole officer, director, and majority shareholder of InTake Communications, Inc. ("InTake"), a Florida corporation, from the date of its incorporation until approximately February 10, 2011. Respondent was the sole officer, director, and majority shareholder of BlueFlash Communications, Inc. ("BlueFlash"), a Florida corporation, from approximately June 20, 2013 to August 23, 2013. Respondent, 60 years old, is a resident of Duluth, Georgia.

Other Relevant Entities and Persons

2. InTake, incorporated in Florida on December 24, 2009, registered an offering of 3,000,000 shares of common stock pursuant to a registration statement effective as of March 25, 2010. InTake's stated principal place of business was in Duluth, Georgia. On February 10, 2011, InTake underwent a change of control pursuant to a stock purchase agreement. Prior to that change of control, InTake had at least three undisclosed parents, promoters, and control persons ("InTake undisclosed control persons").

3. BlueFlash, incorporated in Florida on January 11, 2011, registered an offering of 3,000,000 shares of common stock pursuant to a registration statement effective as of May 13, 2011. On August 23, 2013, BlueFlash underwent a change of control pursuant to a merger agreement. Prior to that change of control, BlueFlash had at least two undisclosed parents, promoters, and control persons ("BlueFlash undisclosed control persons").

Background

4. One of the InTake undisclosed control persons approached Respondent to be the sole officer and director of a company whose sole purpose was to be sold as a public vehicle. This undisclosed control person told Respondent that Respondent would be the sole officer and director of the company in name only, and would be paid a flat fee upon the sale of the company. That company was soon incorporated as InTake on December 24, 2009.

5. On February 2, 2010, InTake 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, and amended its statement on March 8, 2010 and March 23, 2010 (together, the "InTake Registration Statement"). The InTake Registration Statement became effective as of March 25, 2010.

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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.

6. On March 7, 2011, BlueFlash 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, and amended its statement on April 13, 2011 (together, the "BlueFlash Registration Statement"). The BlueFlash Registration Statement became effective as of May 13, 2011.

7. According to the InTake Registration Statement and InTake's other filings with the Commission, Respondent was the President, Director, Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer, majority shareholder, and sole member of management of InTake.

8. The InTake Registration Statement and InTake's other filings with the Commission materially misrepresented that Respondent had capitalized InTake and controlled, and would continue to control, InTake. Respondent knew at all material times that, to the contrary, InTake was capitalized, operated and otherwise controlled by the InTake undisclosed control persons, none of whom was disclosed in any of InTake's filings with the Commission.

9. The InTake Registration Statement and InTake's other filings with the Commission materially misrepresented that InTake's business plan was "to provide software to companies to help them market and sell their music and entertainment content to consumers." Respondent took no actions toward any such business plan for InTake. Respondent knew at all material times that InTake had no purpose other than to engage in a merger or acquisition with an unidentified entity. Therefore, InTake was an undisclosed "blank check company" as defined in Rule 419 under the Securities Act.

10. According to BlueFlash's filings with the Commission, starting on or about June 20, 2013, Respondent was the President, Secretary, Treasurer, Director, Principal Executive Officer, Principal Financial Officer, majority shareholder, and sole member of management of BlueFlash.

11. BlueFlash's filings with the Commission materially misrepresented that Respondent controlled BlueFlash starting on or about June 20, 2013. Respondent knew at all material times that, to the contrary, BlueFlash was operated and otherwise controlled by the BlueFlash undisclosed control persons, none of whom was disclosed in any of BlueFlash's filings with the Commission.

12. The BlueFlash Registration Statement and BlueFlash's other filings with the Commission materially misrepresented that BlueFlash's business plan was "to create, deliver and track all aspects of geo-location based mobile device coupon campaigns that could have a material impact on the young mobile advertising space." Respondent took no actions toward any such business plan for BlueFlash. Respondent knew at all material times that BlueFlash had no purpose other than to engage in a merger or acquisition with an unidentified entity. Therefore, BlueFlash was an undisclosed "blank check company" as defined in Rule 419 under the Securities Act.

13. Respondent took no actions toward devising, designing, maintaining, or evaluating internal accounting controls, disclosure controls and procedures as defined in Rule 15d-15(e) under the Exchange Act ("disclosure controls and procedures"), or internal control over financial reporting

as defined in Rule 15d-15(f) under the Exchange Act ("internal control over financial reporting") for InTake or BlueFlash.

14. InTake filed Forms 10-Q on May 4, 2010, August 6, 2010, and October 18, 2010. Although Respondent did not expressly consent to the use of his electronic signature on these periodic reports and the accompanying certifications, Respondent knew about Intake's periodic reporting requirements, gave consent for his signature to be used in other filings for Intake, and received email confirmations from the Commission upon the filing of Intake's periodic reports containing certifications in his name. These periodic reports and certifications contained material misrepresentations and omissions pertaining to InTake's business plan and Respondent's involvement in InTake, including but not limited to Respondent's purported design, establishment, evaluation, and maintenance of disclosure controls and procedures and internal control over financial reporting.

15. Respondent made materially false statements and omissions in furtherance of InTake's sole purpose as public vehicles for merger or acquisition, including misstatements to broker-dealers in connection with Form 211 applications submitted to the Financial Industry Regulatory Authority (FINRA) regarding InTake's business plan.

16. Respondent received documents containing an electronic version of his signature in furtherance of InTake's sole purpose as a public vehicle for merger or acquisition, including board resolutions and management representation letters to auditors containing false statements related to the issuance of InTake's shares, the accuracy of InTake's disclosures, Respondent's knowledge of fraud involving InTake, and the existence and nature of InTake's disclosure controls and procedures and internal control over financial reporting.

17. Respondent received the stock purchase agreement containing an electronic version of his signature dated February 10, 2011, by which all shares of InTake common stock purportedly owned by Respondent were sold to a third party to effectuate a change of control. This agreement contained materially false representations and warranties with respect to the accuracy of Intake's filings with the Commission, Intake's compliance in all material respects with all applicable laws and regulations (including specifically the Sarbanes-Oxley Act of 2002), and Intake's disclosure controls and procedures and internal control over financial reporting.

18. Respondent signed documents or received documents containing an electronic version of his signature in furtherance of BlueFlash's sole purpose as a public vehicle for merger or acquisition, including Commission filings containing false statements related to Respondent and the predecessor sole officer's involvement in BlueFlash and board resolutions, officer certificates, merger agreements and other documents effectuating the change of control.

19. Respondent took these various actions at the direction of InTake and BlueFlash's undisclosed control persons. Respondent received $11,029.88 upon the sale of InTake and $1,000 upon the sale of BlueFlash as the fees agreed upon with the InTake and BlueFlash undisclosed control persons that had no correlation to Respondent's purported ownership of InTake and BlueFlash shares or the terms of the agreements effectuating the changes of control.

20. As a result of the conduct described above, Respondent willfully violated Section 13(b)(5) of the Exchange Act, which prohibits a person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls or knowingly falsifying any book, record or account described in Section 13(b)(2) of the Exchange Act.

21. As a result of the conduct described above, Respondent willfully violated Rule 13b2-1 under the Exchange Act, which prohibits a person from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act.

22. As a result of the conduct described above, Respondent willfully violated Rule 13b2-2 under the Exchange Act, which prohibits an officer or director of an issuer to make or cause to be made, or omit or cause another person to omit to state, a materially false or misleading statement to an accountant in connection with the preparation or filing of any document or report required to be filed with the Commission.

23. As a result of the conduct described above, Respondent violated Rule 15d-14 under the Exchange Act, which requires that the principal executive and principal financial officers of an issuer that files a report pursuant to Section 15(d) of the Exchange Act sign a certification that, among other things and based on their knowledge, the periodic report filed with the Commission does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading.

24. As a result of the conduct described above, Respondent violated Rule 15d-15 under the Exchange Act, which requires the management of an issuer that files reports pursuant to Section 15(d) of the Exchange Act to evaluate the effectiveness of the issuer's disclosure controls and procedures, and which requires the management of an issuer that either had been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act, or had previously filed an annual report, to evaluate the effectiveness of the issuer's internal control over financial reporting.

25. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by the InTake and BlueFlash undisclosed control persons of Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

26. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by the InTake and BlueFlash undisclosed control persons of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

27. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by InTake and BlueFlash of Section 13(b)(2)(A) of the Exchange Act, which requires that an issuer which is required to file reports pursuant to Section 15(d) of

the Exchange Act make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

28. As a result of the conduct described above, Respondent aided and abetted and caused violations by InTake and BlueFlash of Section 13(b)(2)(B) of the Exchange Act, which requires that an issuer which is required to file reports pursuant to Section 15(d) of the Exchange Act devise and maintain a system of internal accounting controls.

29. As a result of the conduct described above, Respondent aided and abetted and caused violations by InTake of Section 15(d) of the Exchange Act, Rules 12b-11, 12b-20, 15d-13 and 15d-14 thereunder and willfully aided and abetted and caused violations by InTake of Rule 302 of Regulation S-T, which require that an issuer which has filed a registration statement which has become effective pursuant to the Securities Act file periodic information, documents, and reports as required pursuant to Section 13 of the Exchange Act, including quarterly reports on Form 10-Q, and that such reports be signed, contain such material information as may be necessary to make the required statements in light of the circumstances under which they are made not misleading, and include certifications signed by the issuer's principal executive and principal financial officers.

30. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by InTake and BlueFlash of Rule 13b2-1 under the Exchange Act, which prohibits a person from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act.

31. As a result of the conduct described above, Respondent aided and abetted and caused violations by InTake and BlueFlash of Rule 15d-15 under the Exchange Act, which requires an issuer that files reports pursuant to Section 15(d) of the Exchange Act to evaluate the effectiveness of the issuer's disclosure controls and procedures, and which requires an issuer that either had been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act, or had previously filed an annual report, to evaluate the effectiveness of the issuer's internal control over financial reporting.

Disgorgement and Civil Penalties

32. Respondent has submitted a sworn Statement of Financial Condition dated November 18, 2014 and other evidence, and has asserted his inability to pay a civil penalty.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Warren'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. Respondent Warren cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Sections 10(b), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5) and 15(d) of the Exchange Act and Rules 10b-5, 12b-11, 12b-20, 13b2-1, 13b2-2, 15d-13, 15d-14 and 15d-15 promulgated thereunder, and Rule 302 of Regulation S-T.

B. Respondent Warren be, and hereby is:

> prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act; and

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

C. Respondent shall pay disgorgement, which represents profits gained as a result of the conduct described herein of $12,029.88 and prejudgment interest of $1,380.87 to the Securities and Exchange Commission, of which $6,705.38 shall be paid within 10 days of the entry of this Order and $6,705.37 shall be paid within 180 days of the entry of this Order. 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 Ronald A. Warren 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 Glenn S. Gordon, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131. Based upon Respondent's sworn representations in his

Statement of Financial Condition dated November 18, 2014 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

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

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74752 / April 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16497

In the Matter of **R. SCOTT PEDEN, ESQ.,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3)(i)(A) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against R. Scott Peden ("Respondent" or "Peden") pursuant to Rule 102(e)(3)(i)(A)[1] of the Commission's Rules of Practice (17 C.F.R. § 200.102(e)(3)(i)(A)).

II.

The Commission finds that:

1. Peden is an attorney licensed in the State of Texas.

2. Peden was the General Counsel and Secretary of Life Partners Holdings, Inc. ("LPHI"), a publically-traded financial services company that operates through a wholly-owned

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

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any attorney . . . who has been by name: (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 . . . .

subsidiary, Life Partners, Inc. ("LPI"). Peden also served as President of LPI. LPHI facilitated the purchase and sale of fractional interests of life insurance policies in the secondary market known as "life settlements."

3. On January 3, 2012, the Commission filed a complaint against Peden and others in the United States District Court for the Western District of Texas charging that Peden aided and abetted the violation of Section 13(a) of the Securities Exchange Act of 1934 ("the Exchange Act"), and Rules 12b-20, 13a-1 and 13a-13thereunder, among other violations of the securities laws. *SEC v. Life Partners Holdings, Inc., et al.*, Case Number 1:12-cv-00033-JRN-AWA (W.D. Tex). The complaint alleged that Peden and others knowingly aided and abetted the submission of numerous false or misleading statements in filings with the Commission on behalf of LPHI. Specifically, the complaint alleged that the filings materially misstated LPHI's net income from fiscal year 2006 through the third quarter of fiscal year 2011 by prematurely recognizing revenues and understating impairment expenses related to the company's investments in life settlements. As to Peden, the complaint sought a permanent injunction; disgorgement with prejudgment interest; civil monetary penalties; and an officer-and-director bar.

4. On January 16, 2015, the court entered a final judgment against Peden, permanently enjoining him from future violations of Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-13 and 13a-14 thereunder, and from aiding and abetting violations of Section 13(a) and Rules 12b-20, 13a-1, and 13a-13, and imposing a civil penalty of $2,000,000.

III.

Based on the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Peden, an attorney, from violating the Federal securities laws within the meaning of Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice. In view of this finding, the Commission deems it appropriate and in the public interest that Peden be temporarily suspended from appearing or practicing before the Commission as an attorney.

IT IS HEREBY ORDERED that Peden be, and hereby is, temporarily suspended from appearing or practicing before the Commission as an attorney. This Order will be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Peden may, within thirty days after service of this Order, file a petition with the Commission to lift the temporary suspension. If the Commission receives no petition within thirty days after service of the Order, the suspension will become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission will, within thirty days after the filing of the petition, either lift the temporary suspension, or schedule the matter for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Peden personally or by certified mail at his last known address or his attorney's address.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: 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. 4062 / April 16, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31553 / April 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-11359

In the Matter of **ALLIANCE CAPITAL MANAGEMENT, L.P.** **Respondent.**	**ORDER MODIFYING AMENDED ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

On January 15, 2004, the Securities and Exchange Commission ("Commission") issued an amended order instituting public administrative and cease-and-desist proceedings pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 (the "2004 Order"),[1] against Alliance Capital Management, L.P., now known as AllianceBernstein, L.P. ("Alliance" or "Respondent").

II.

Respondent consented to the entry of the 2004 Order. Among other things, the 2004 Order required Respondent to cease and desist from further violations of the federal securities laws, directed Respondent to pay disgorgement and civil money penalties, and directed Respondent to comply with certain undertakings.

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1 See Investment Advisers Act Rel. No. 2205A, January 15, 2004, Admin. Proc. File No. 3-11359.

III.

Respondent has submitted an Amended Offer of Settlement (the "Offer") proposing to relieve Respondent of its undertakings to hold shareholder meetings every five years to elect directors of the boards of the Alliance mutual funds in accordance with Section III.62.c of the 2004 Order and to designate an independent compliance officer to advise the boards of the Alliance mutual funds about Respondent's compliance with the federal securities laws, Respondent's fiduciary duties to the shareholders of the Alliance mutual funds and Respondent's Code of Ethics in accordance with Section III.62.d of the 2004 Order. 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 in the 2004 Order, 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 Modifying Amended Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, as set forth below.

IV.

The Commission deems it appropriate and in the public interest to amend the 2004 Order as agreed to in Respondent's Offer.

Accordingly, IT IS HEREBY ORDERED that:

A. Section III.62.c of the 2004 Order is amended as follows to order:

In 2005 and 2010, each Alliance fund will hold a meeting of shareholders at which the board of directors will be elected.

B. Section III.62.d of the 2004 Order is amended as follows to order:

Until at least December 31, 2014, each Alliance fund will designate an independent compliance officer reporting to its board of directors as being responsible for assisting the board of directors and any of its committees in monitoring compliance by Alliance with the federal securities laws, Alliance's fiduciary duties to fund shareholders and Alliance's Code of Ethics in all matters relevant to the operation of the Alliance funds. The duties of this person will include reviewing all compliance reports furnished to the board of directors or its committees by Alliance, attending meetings of Alliance's Internal Compliance Controls Committee to be established pursuant to Alliance's undertakings set forth in Section IV of the 2004 Order, serving as liaison between the board of directors and its committees and the Chief Compliance Officer of Alliance, making such recommendations to the board of directors regarding Alliance's compliance procedures as may appear advisable from time to time, and promptly reporting to the board of directors any material breach of fiduciary duty, breach of the Code of Ethics and/or violations of the federal securities laws of which he or she becomes aware in the course of carrying out his or her duties.

C. All other provisions of the 2004 Order remain in effect.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4063 / April 16, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31554 / April 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16130

In the Matter of

SEAN C. COOPER,

Respondent.

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to enter this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") as to Sean C. Cooper ("Respondent" or "Cooper").[1]

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Respondent admits the facts set forth in Annex A attached hereto and acknowledges that his conduct as set forth in Annex A violated the federal securities laws, admits the Commission's jurisdiction over him and the subject matter of these proceedings, and consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(f)

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[1] On September 17, 2014, the Commission instituted public administrative and cease-and-desist proceedings pursuant to Sections 203(f) and 203(k) of the Advisers Act and Section 9(b) of the Investment Company Act against Cooper.

and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, as set forth below.

III.

On the basis of this Order and Cooper's Offer, the Commission finds[2] that:

Summary

1. This proceeding involves fraud, breaches of fiduciary duty, and compliance failures by Sean C. Cooper from 2010 to 2012. During that period, Cooper was a managing member of WestEnd Capital Management, LLC ("WestEnd"), a San Francisco-based registered investment adviser, and also the portfolio manager for WestEnd Partners L.P. ("Fund"), a hedge fund advised by WestEnd.

2. The Fund's governing documents provided that WestEnd was entitled to annual management fees of 1.5% payable quarterly in advance at the beginning of each fiscal quarter. However, beginning in March 2010 and continuing through February 2012, Cooper began indiscriminately withdrawing money from the Fund. Cooper routed the money first through WestEnd, and then to his personal bank accounts. Although Cooper characterized the withdrawals in WestEnd's books and records as management fees, the withdrawals bore no relation to the fees WestEnd actually had earned. In reality, Cooper was using the Fund to line his own pockets. By April 1, 2012, Cooper had misappropriated $211,579 from the Fund.

3. Cooper was primarily responsible for WestEnd's compliance program, which was deficient with regards to, among other things, monitoring, reviewing, and approving his withdrawals from the Fund. Cooper also signed a false Form ADV filed with the Commission by WestEnd in 2011.

Respondent

4. **Sean Cooper**, age 48, of New Orleans, Louisiana, served as one of WestEnd's managing members since its inception in 2002 through his expulsion from the firm in August 2012. Cooper was the primary portfolio manager and made almost all the investment decisions for the Fund. He also served as WestEnd's chief compliance employee until 2007, when he nominally delegated that function to another employee. In 2003, he formed the Fund to invest primarily in securities traded on domestic exchanges. Cooper controlled the Fund's operations and paid himself 100% of the management fee WestEnd collected from the Fund.

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

Other Relevant Entities

5. **WestEnd Capital Management, LLC** ("WestEnd") is a California limited liability corporation based in San Francisco, CA and has been registered with the Commission as an investment adviser since May 2002. WestEnd provides investment advice to individuals and is also the investment adviser to WestEnd Partners, L.P., a hedge fund. As of December 31, 2013, WestEnd's total assets under management were $105 million.

6. **WestEnd Partners, L.P.** (the "Fund") is a California limited partnership formed in 2003, with WestEnd as its General Partner and adviser. During the relevant period WestEnd Partners invested primarily in securities traded on domestic and foreign exchanges and had approximately 20 investors.

Background

7. Formed in 2002, WestEnd is an investment advisory firm registered with the Commission that provides advisory and financial planning services to high net-worth individuals through separately managed accounts and the Fund.

8. Sean Cooper and two other members (the "Other Members") owned and operated WestEnd. Cooper was responsible for WestEnd's back office financial operations and compliance matters, as well as managing the Fund's investment portfolio. The Other Members were responsible for managing WestEnd's other client portfolios as well as client relations and marketing, and performed their roles remotely. As a result, the Other Members oversaw very little of WestEnd's day-to-day operations during the relevant time period. Cooper hired most of WestEnd's employees, ran WestEnd's day-to-day operations, purported to supervise WestEnd's compliance policies and procedures, served as the primary portfolio manager for the Fund, made almost all of the investment decisions for the Fund, and coordinated the preparation of the Fund's financial statements. He also had sole control over the Fund's bank accounts and operations and collected the fees WestEnd earned from the Fund. Cooper operated the Fund and managed WestEnd's back office operations with little to no supervision from WestEnd's Other Members.

Cooper Misappropriated Fund Assets

9. The Fund's offering circular stated that WestEnd was entitled to annual management fees of 1.5% of each investors' capital account balance, payable quarterly in advance at the beginning of each fiscal quarter. The Fund's limited partnership agreement similarly stated that WestEnd was entitled to a management fee of 0.375 % of the balance of each limited partner's capital account on the first day of each fiscal quarter.

10. WestEnd operated its fiscal calendar on a calendar year basis, such that WestEnd could withdraw quarterly management fees starting on January 1, April 1, July 1, and September 1 of each year. WestEnd provided each prospective investor in the Fund

with a copy of the Fund's confidential offering circular and limited partnership agreement. Cooper knew investors received copies of these documents.

11. In March 2010, however, Cooper began indiscriminately withdrawing money from the Fund. Whereas the Fund's confidential offering circular and limited partnership agreement stated that there would be 4 quarterly management fee payments, Cooper withdrew fees 11 times in various amounts during 2010 that in total exceeded the 1.5% level, causing WestEnd's financial statements to state that it owed investors in the Fund $128,950 by the end of that year. Cooper continued to collect excess fees from the Fund in 2011 and 2012 and by March 2012, WestEnd's financial statements reflected that it owed the Fund $320,779. When the Commission's examination staff began an onsite examination in April 2012 the amount WestEnd owed to the Fund had been reduced by $109,200 to $211,579 due to the April 1, 2012 accrual of management fees. Cooper characterized the withdrawals in the Fund's books and records as management fees – but the withdrawals bore no relation to the fees WestEnd actually had earned. In reality, Cooper simply was using the Fund as his own private bank.

12. Cooper had sole authority to transfer money out of the Fund and there were no controls in place to prevent him from improperly withdrawing funds. Cooper routed the money first through WestEnd, and then to his personal bank account where he spent the money on his lavish lifestyle, including remodeling his multi-million dollar Marin County home and purchasing a $187,000 Porsche. In June 2012, the Fund's independent auditors determined that WestEnd's lack of internal control over monitoring and approval of Cooper's withdrawals in excess of the amounts permitted by the Fund's governing documents was a significant deficiency in internal controls.

13. Cooper did not disclose WestEnd's excess fee withdrawals to Fund investors. Although Cooper reviewed and approved the quarterly account statements WestEnd sent to Fund investors, these statements, which reflected quarterly and year-to-date performance of the Fund, did not disclose the fact that Cooper caused WestEnd to take more in management fees than WestEnd was entitled to take under the terms of the Fund's offering and governing documents. Cooper also reviewed and approved the Fund's 2010 financial statements, which WestEnd sent to investors in July 2011, well after Cooper had misappropriated most of the funds. These financial statements described Cooper's withdrawals as "Prepaid management fees." This was false and misleading because Cooper's withdrawals bore no relation to the fees he and WestEnd actually earned.

False Statement in Form ADV

14. On April 1, 2011, Cooper signed and filed on behalf of WestEnd Part 2A of WestEnd's Form ADV. Item 5 of Part 2A stated that WestEnd charged a quarterly management fee, payable on the first day of each quarter, equal to 0.375% of the capital balance of each limited partner for its services to the Fund. As discussed above, this statement was false, because Cooper indiscriminately withdrew purported management fees in excess of the annual 1.5% in 2010, 2011, and 2012.

Cooper Aided and Abetted and Caused WestEnd's Compliance Violations

15. The Advisers Act requires that registered investment advisers adopt and implement written policies and procedures reasonably designed to prevent violations of the statute. WestEnd failed to adopt, implement or comply with written policies and procedures designed to prevent violations of the Advisers Act. Cooper, while acting as WestEnd's chief compliance employee, failed to adopt, implement, or direct WestEnd's employees to adopt, implement, or comply with written policies and procedures designed to prevent violations of the Advisers Act.

16. As noted above, WestEnd – at Cooper's direction as principal of WestEnd and chief compliance officer ("Compliance Officer") – did not adopt policies or procedures that placed restrictions on Cooper's ability to withdraw money from the Fund. Additionally, WestEnd's policies and procedures that were adopted required that employees on an annual basis review and certify that they had received, read, and complied with the policies and procedures. WestEnd did not, however, provide its employees with the policies and procedures on an annual basis. Moreover, none of WestEnd's managing members, including Cooper, reviewed and certified that they had complied with WestEnd's policies and procedures for a more than five-year period between 2006 and 2012.

17. The Advisers Act also requires that registered investment advisers review, no less frequently than annually, the adequacy of their compliance policies and the effectiveness of their implementation. Similarly, WestEnd's policies and procedures required Cooper to conduct an annual review of the adequacy and effectiveness of the firm's policies and procedures, including considering any compliance matters that arose during the previous year, any changes in WestEnd's activities and any changes in the Advisers Act or other applicable regulations. From 2006 through 2012, WestEnd and Cooper failed to conduct an annual review of the policies and procedures as required under the Advisers Act.

Violations

18. As a result of the conduct described above, Cooper willfully violated Sections 206(1) and 206(2) of the Advisers Act by employing devices, schemes or artifices to defraud clients or engaging in transactions, practices or courses of business that defrauded clients or prospective clients.

19. As a result of the conduct described above, Cooper willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit any fraudulent, deceptive, or manipulative act, practice, or course of business by an investment adviser to a pooled investment vehicle.

20. As a result of the conduct described above, Cooper willfully aided and abetted and caused WestEnd's violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser: (a) adopt and implement written policies and procedures reasonably designed to

prevent violations of the Advisers Act and its rules; and (b) review at least annually its written policies and procedures and the effectiveness of their implementation.

21. As a result of the conduct described above, Cooper 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."

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Cooper'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 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)-7 and 206(4)-8 thereunder.

B. Respondent Cooper be, and hereby is

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and
>
> prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

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

D. Respondent shall, within 60 days of the entry of this Order, pay disgorgement, which represents profits gained as a result of the conduct described herein of

$211,579; a civil money penalty in the amount of $175,000; and prejudgment interest of $15,746.58, for a total of $402,325.58 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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

Payments by check or money order must be accompanied by a cover letter identifying Sean C. Cooper as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Erin E. Schneider, Associate Regional Director, San Francisco Regional Office, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104.

V.

It is further Ordered that, 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

ANNEX A

Respondent Sean C. Cooper admits the facts set forth below (the "Admissions") and acknowledges that his conduct violated the federal securities laws:

WestEnd Capital Management

1. WestEnd Capital Management, LLC ("WestEnd") is a California limited liability corporation based in San Francisco, CA and has been registered with the Commission as an investment adviser since May 2002. WestEnd provides investment advice to individuals and is also the investment adviser to WestEnd Partners, L.P., a hedge fund. Cooper was a managing member of WestEnd from inception until August 2012.

WestEnd Partners

2. WestEnd Partners, L.P. (the "Fund") is a California limited partnership formed in 2003, with WestEnd as its General Partner and adviser. Cooper was the portfolio manager of the Fund. From January 2010 through February 2012 (the "Relevant Period") WestEnd Partners invested primarily in securities traded on domestic and foreign exchanges and had approximately 20 investors and net assets ranging from $24 to $85 million during the Relevant Period.

Background

3. Sean Cooper and two other members (the "Other Members") owned and operated WestEnd. Cooper was responsible for WestEnd's back office financial operations and compliance matters, as well as managing the Fund's investment portfolio. The Other Members were responsible for managing WestEnd's other client portfolios as well as client relations and marketing, and performed their roles remotely. Cooper hired most of WestEnd's employees, ran WestEnd's day-to-day operations, supervised WestEnd's compliance policies and procedures, served as the primary portfolio manager for the Fund, made almost all of the investment decisions for the Fund, and coordinated the preparation of the Fund's financial statements. He also had sole control over the Fund's bank accounts and operations and collected the fees WestEnd earned from the Fund.

Calculation and Disclosure of Management Fees Paid by the Fund

4. The Fund's offering circular stated that WestEnd was entitled to annual management fees of 1.5% of each investor's capital account balance, payable quarterly in advance at the beginning of each fiscal quarter. The Fund's limited partnership agreement similarly stated that WestEnd was entitled to a management fee of 0.375 % of the balance of each limited partner's capital account on the first day of each fiscal quarter.

5. According to the terms of the Fund's confidential offering circular and limited partnership agreement, WestEnd operated its fiscal calendar on a calendar year basis, such that WestEnd could withdraw quarterly management fees starting on January 1,

April 1, July 1, and September 1 of each year. WestEnd provided each prospective investor in the Fund with a copy of the Fund's confidential offering circular and limited partnership agreement before they invested in the fund. Cooper knew investors received copies of these documents.

Cooper's Improper Collection of Management Fees

6. Contrary to the terms of the Fund's confidential offering circular and limited partnership agreement, Cooper withdrew purported fees in 2010, 2011, and 2012 in various amounts that in total exceeded the 1.5% level.

7. Cooper withdrew purported fees 11 times from the Fund in the following amounts in 2010:

a. $100,000 on January 4, 2010;

b. $75,000 on March 9, 2010;

c. $15,000 on March 18, 2010;

d. $60,000 on May 12, 2010;

e. $13,500 on May 13, 2010;

f. $10,000 on June 21, 2010;

g. $45,000 on August 4, 2010;

h. $45,000 on September 1, 2010;

i. $30,000 on September 27, 2010;

j. $140,000 on October 21, 2010;

k. $20,000 on December 10, 2010.

8. By December 31, 2010, due to these withdrawals, Cooper owed the Fund $128,950.

9. Cooper withdrew purported fees 6 times from the Fund in the following amounts in 2011:

a. $200,000 on February 1, 2011;

b. $160,000 on February 10, 2011;

c. $150,000 on March 8, 2011;

d. $80,000 on April 14, 2011;

e. $100,000 on April 28, 2011;

f. $50,000 on May 18, 2011.

10. By December 31, 2011, due to these additional withdrawals, Cooper owed the Fund $281,749.

11. On February 23, 2012, Cooper withdrew an additional $100,000 in purported fees, raising the total amount Cooper owed the Fund to $320,779. During the Relevant Period, Cooper was reckless in taking out fees in a manner contrary to what was described in the materials provided to the investors. Additionally, Cooper did not disclose this to investors.

False Statements in WestEnd's Form ADV

12. On April 1, 2011, WestEnd filed with the Commission, Part 2A of WestEnd's Form ADV. Item 5 of Part 2A stated that WestEnd charged a quarterly management fee, payable on the first day of each quarter, equal to 0.375% of the capital balance of each limited partner for its services to the Fund. This was false because Cooper took purported fees in a manner contrary to the statement. Cooper signed and filed Part 2A of WestEnd's Form ADV on behalf of WestEnd.

Inadequate Compliance Policies and Procedures

13. Section 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 206(4)-7 promulgated thereunder require that registered investment advisers adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. WestEnd's Form ADV from 2009 through 2011, which Cooper signed, identified him as WestEnd's Chief Compliance Officer. Cooper was aware as Chief Compliance Officer that he was in charge of adopting and implementing WestEnd's compliance policies and procedures. Cooper, while acting as WestEnd's Chief Compliance Officer, failed to adopt, implement, or direct WestEnd's employees to adopt, implement, or comply with written policies and procedures designed to prevent violations of the Advisers Act and its rules. For example, WestEnd – at Cooper's direction as principal of WestEnd and Chief Compliance Officer – did not adopt policies or procedures that placed restrictions on Cooper's ability to withdraw money from the Fund. The Fund's auditor concluded at the end of its 2011 audit that WestEnd's lack of control over monitoring and approval of Cooper's withdrawals in excess of the amounts permitted by the Fund's governing documents was a significant deficiency in internal controls.

14. WestEnd's policies and procedures – adopted while Cooper was WestEnd's Chief Compliance Officer – required that employees on an annual basis review and certify that they had received, read, and complied with the policies and procedures. Cooper did not, however, provide or cause others to provide WestEnd employees with the policies and procedures on an annual basis. Moreover, Cooper, a managing member of WestEnd, did not review and certify that he had complied with WestEnd's policies and procedures for a more than five-year period between 2006 and 2012.

15. The Advisers Act also requires that registered investment advisers review, no less frequently than annually, the adequacy of their compliance policies and the effectiveness of their implementation. Similarly, WestEnd's policies and procedures required Cooper to conduct an annual review of the adequacy and effectiveness of the firm's policies and procedures, including considering any compliance matters that arose during the previous year, any changes in WestEnd's activities and any changes in the Advisers Act or other applicable regulations. From 2006 through 2012, Cooper was reckless in disregarding the Advisers Act requirements that he conduct or cause others to conduct an annual review of the policies and procedures as required under the Act, as well as under the terms of WestEnd's compliance manual.

Ill-Gotten Gains

16. As of February 23, 2012, WestEnd had taken $320,779 more than it was entitled to from the Fund. WestEnd transferred nearly all of this excessive amount to Cooper. On April 1, 2012, WestEnd reduced the amount owed to the Fund to $211,579 by not taking the $109,200 in management fees that had accrued for the current quarter.

Conclusion

17. The above-described conduct by Cooper was undertaken while he was serving as a managing member of a SEC-registered investment adviser.

18. In connection with the violations described in the foregoing Admissions, Cooper's actions were, at a minimum, reckless.

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9750 / April 16, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74751 / April 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16496

In the Matter of

KEVIN D. MILLER

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 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 Kevin D. Miller ("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, and except as provided herein in Section V, 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[1] that:

Respondent

1. Respondent was the sole officer, director, and majority shareholder of Mobieyes Software, Inc. ("Mobieyes Software"), a Florida corporation, until approximately February 9, 2010. Respondent, 56 years old, is a resident of Alpharetta, Georgia.

Other Relevant Entities and Persons

2. Mobieyes Software, incorporated in Florida on January 15, 2009, registered an offering of 3,000,000 shares of common stock pursuant to a registration statement effective as of June 3, 2009. Mobieyes Software's stated principal place of business was in Milton, Georgia. On February 9, 2010, Mobieyes Software underwent a change of control pursuant to a stock purchase agreement. Prior to that change of control, Mobieyes Software had at least three undisclosed parents, promoters, and control persons ("undisclosed control persons").

Background

3. One of the undisclosed control persons approached Respondent and asked him to be the sole officer and director of a company whose sole purpose was to be sold as a public vehicle. This undisclosed control person told Respondent that Respondent would be the sole officer and director of the company until it could be sold and merged with another operating company. Respondent understood his responsibilities as the sole officer and director of the company would be administrative and ministerial because the proposed company would have no operations until it was sold. The undisclosed control person told Respondent he would receive a $10,000 flat fee upon the sale of the company for providing these services. That company was soon incorporated as Mobieyes Software on January 15, 2009.

4. On February 27, 2009, Mobieyes Software 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, and amended its statement on April 8, 2009, April 29, 2009 and May 20, 2009 (together, the "Registration Statement"). The Registration Statement became effective as of June 3, 2009.

5. According to the Registration Statement and Mobieyes Software's other filings with the Commission, Respondent was the President, Sole Director, Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer, majority shareholder, and sole member of management of Mobieyes Software.

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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.

6. The Registration Statement and Mobieyes Software's other filings with the Commission claimed that Respondent had capitalized Mobieyes Software and controlled, and would continue to control, Mobieyes Software. Respondent knew at all material times that, to the contrary, Mobieyes Software was capitalized, operated and otherwise controlled by the undisclosed control persons, none of whom was disclosed in any of Mobieyes Software's filings with the Commission.

7. The Registration Statement and Mobieyes Software's other filings with the Commission claimed that Mobieyes Software was "a mobile enterprise software company aimed at improving the productivity of the field service organization." Respondent took no actions toward any such business plan for Mobieyes Software. Respondent understood and believed that Mobieyes Software had no purpose other than to engage in a merger or acquisition with an unidentified entity. Therefore, Mobieyes Software was an undisclosed "blank check company" as defined in Rule 419 under the Securities Act.

8. Respondent took no actions toward devising, designing, maintaining, or evaluating internal accounting controls, disclosure controls and procedures as defined in Rule 15d-15(e) under the Exchange Act ("disclosure controls and procedures"), or internal control over financial reporting as defined in Rule 15d-15(f) under the Exchange Act ("internal control over financial reporting") for Mobieyes Software.

9. The undisclosed control persons assembled Mobieyes Software's Forms 10-Q filed on June 4, 2009, September 14, 2009, and December 10, 2009, and Form 10-K filed on February 9, 2010. These periodic reports and certifications contained material misrepresentations and omissions pertaining to Mobieyes Software's business plan and Respondent's involvement in Mobieyes Software, including but not limited to Respondent's purported design, establishment, evaluation, and maintenance of disclosure controls and procedures and internal control over financial reporting. Although Respondent did not expressly consent to the use of his electronic signature on these periodic reports and the accompanying certifications, Respondent signed management representation letters in connection with Mobieyes Software's periodic reports and received email confirmations from the Commission upon the filing of Mobieyes Software's periodic reports containing certifications signed in his name.

10. At the direction of the undisclosed control persons, Respondent signed other documents in furtherance of Mobieyes Software's sole purpose as a public vehicle for merger or acquisition, including board resolutions, an affidavit and due diligence questionnaire in support of a Form 211 application, and management representation letters to auditors. These documents contained false or misleading statements related to the issuance of Mobieyes Software's shares, the accuracy of Mobieyes Software's disclosures, Respondent's knowledge of fraud involving Mobieyes Software, and the existence and nature of Mobieyes Software's disclosure controls and procedures and internal control over financial reporting.

11. Respondent took these various actions at the direction of Mobieyes Software's undisclosed control persons. Respondent received $10,000 upon the sale of Mobieyes Software as

the flat fee agreed upon with the undisclosed control persons which had no correlation to the value of Respondent's Mobieyes Software shares per the change-of-control transaction.

12. As a result of the conduct described above, Respondent willfully violated Section 13(b)(5) of the Exchange Act, which prohibits a person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls or knowingly falsifying any book, record or account described in Section 13(b)(2) of the Exchange Act.

13. As a result of the conduct described above, Respondent willfully violated Rule 13b2-1 under the Exchange Act, which prohibits a person from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act.

14. As a result of the conduct described above, Respondent willfully violated Rule 13b2-2 under the Exchange Act, which prohibits an officer or director of an issuer to make or cause to be made, or omit or cause another person to omit to state, a materially false or misleading statement to an accountant in connection with the preparation or filing of any document or report required to be filed with the Commission.

15. As a result of the conduct described above, Respondent violated Rule 15d-14 under the Exchange Act, which requires that the principal executive and principal financial officers of an issuer that files a report pursuant to Section 15(d) of the Exchange Act sign a certification that, among other things and based on their knowledge, the periodic report filed with the Commission does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading.

16. As a result of the conduct described above, Respondent violated Rule 15d-15 under the Exchange Act, which requires the management of an issuer that files reports pursuant to Section 15(d) of the Exchange Act to evaluate the effectiveness of the issuer's disclosure controls and procedures, and which requires the management of an issuer that either had been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act, or had previously filed an annual report, to evaluate the effectiveness of the issuer's internal control over financial reporting.

17. As a result of the conduct described above, Respondent caused violations by the undisclosed control persons of Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

18. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by the undisclosed control persons of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

19. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by Mobieyes Software of Section 13(b)(2)(A) of the Exchange Act, which requires that an issuer which is required to file reports pursuant to Section 15(d) of the Exchange Act make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

20. As a result of the conduct described above, Respondent aided and abetted and caused violations by Mobieyes Software of Section 13(b)(2)(B) of the Exchange Act, which requires that an issuer which is required to file reports pursuant to Section 15(d) of the Exchange Act devise and maintain a system of internal accounting controls.

21. As a result of the conduct described above, Respondent aided and abetted and caused violations by Mobieyes Software of Section 15(d) of the Exchange Act, Rules 12b-11, 12b-20, 15d-1, 15d-13 and 15d-14 thereunder and willfully aided and abetted and caused violations by Mobieyes Software of Rule 302 of Regulation S-T, which require that an issuer which has filed a registration statement which has become effective pursuant to the Securities Act file periodic information, documents, and reports as required pursuant to Section 13 of the Exchange Act, including quarterly reports on Form 10-Q and annual reports on Form 10-K, and that such reports be signed, contain such material information as may be necessary to make the required statements in light of the circumstances under which they are made not misleading, and include certifications signed by the issuer's principal executive and principal financial officers.

22. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by Mobieyes Software of Rule 13b2-1 under the Exchange Act, which prohibits a person from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act.

23. As a result of the conduct described above, Respondent aided and abetted and caused violations by Mobieyes Software of Rule 15d-15 under the Exchange Act, which requires an issuer that files reports pursuant to Section 15(d) of the Exchange Act to evaluate the effectiveness of the issuer's disclosure controls and procedures, and which requires an issuer that either had been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act, or had previously filed an annual report, to evaluate the effectiveness of the issuer's internal control over financial reporting.

Disgorgement and Civil Penalties

24. Respondent has submitted a sworn Statement of Financial Condition dated October 14, 2014 and other evidence, and has asserted his inability to pay full disgorgement plus prejudgment interest or a civil penalty.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Miller'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. Respondent Miller cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Sections 10(b), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5) and 15(d) of the Exchange Act and Rules 10b-5, 12b-11, 12b-20, 13b2-1, 13b2-2, 15d-1, 15d-13, 15d-14 and 15d-15 promulgated thereunder, and Rule 302 of Regulation S-T.

B. Respondent Miller be, and hereby is:

prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act; and

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

C. Respondent shall pay disgorgement of $10,000 which represents profits gained as a result of the conduct described herein, and prejudgment interest of $1,652.20, but that, based upon Respondent's sworn representations in his Statement of Financial Condition dated October 14, 2014 and other documents submitted to the Commission, payment of such amount is waived except $5,000, of which $2,500 shall be paid within 10 days of the entry of this Order and $2,500 shall be paid within 365 days of the entry of this Order. 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 Kevin D. Miller 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 Glenn S. Gordon, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131. Based upon Respondent's sworn representations in his Statement of Financial Condition dated October 14, 2014 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

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

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9748 / April 16, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74749 / April 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16494

In the Matter of **WILLIAM J. GAFFNEY** **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 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 William J. Gaffney ("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, and except as provided herein in Section V, 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[1] that:

Respondent

1. Respondent was the sole officer, director, and majority shareholder of mBeach Software, Inc. ("mBeach Software"), a Florida corporation, until approximately June 15, 2010. Respondent, 55 years old, is a resident of Cumming, Georgia.

Other Relevant Entities and Persons

2. mBeach Software, incorporated in Florida on April 24, 2009, registered an offering of 3,000,000 shares of common stock pursuant to a registration statement effective as of November 10, 2009. mBeach Software's stated principal place of business was in Cumming, Georgia. On June 15, 2010, mBeach Software underwent a change of control pursuant to a stock purchase agreement. Prior to that change of control, mBeach Software had at least three undisclosed parents, promoters, and control persons ("undisclosed control persons").

Background

3. One of the undisclosed control persons approached Respondent to be the sole officer and director of a company whose sole purpose was to be sold as a public vehicle. This undisclosed control person told Respondent that Respondent would be the sole officer and director of the company in name only, and would be paid a flat fee upon the sale of the company. That company was soon incorporated as mBeach Software on April 24, 2009.

4. On June 9, 2009, mBeach Software 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, and amended its statement on July 24, 2009, September 18, 2009, October 21, 2009, and November 4, 2009 (together, the "Registration Statement"). The Registration Statement became effective as of November 10, 2009.

5. According to the Registration Statement and mBeach Software's other filings with the Commission, Respondent was the President, Secretary, Treasurer, Sole Director, Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer, majority shareholder, and sole member of management of mBeach Software.

6. The Registration Statement and mBeach Software's other filings with the Commission materially misrepresented that Respondent had capitalized mBeach Software and controlled, and would continue to control, mBeach Software. Respondent knew at all material

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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.

times that, to the contrary, mBeach Software was capitalized, operated and otherwise controlled by the undisclosed control persons, none of whom was disclosed in any of mBeach Software's filings with the Commission.

7. The Registration Statement and mBeach Software's other filings with the Commission materially misrepresented that mBeach Software's business plan was "to develop and market mobile software." Respondent took no actions toward any such business plan for mBeach Software. Respondent knew at all material times that mBeach Software had no purpose other than to engage in a merger or acquisition with an unidentified entity. Therefore, mBeach Software was an undisclosed "blank check company" as defined in Rule 419 under the Securities Act.

8. Respondent took no actions toward devising, designing, maintaining, or evaluating internal accounting controls, disclosure controls and procedures as defined in Rule 15d-15(e) under the Exchange Act ("disclosure controls and procedures"), or internal control over financial reporting as defined in Rule 15d-15(f) under the Exchange Act ("internal control over financial reporting") for mBeach Software.

9. mBeach Software filed Forms 10-Q on December 10, 2009 and March 9, 2010, and a Form 10-K on May 17, 2010. Although Respondent did not expressly consent to the use of his electronic signature on these periodic reports and the accompanying certifications, Respondent signed management representation letters in connection with mBeach Software's periodic reports, received email confirmations from the Commission upon the filing of mBeach Software's periodic reports containing certifications signed in his name, and consented to the use of his electronic signature with respect to other documents in connection with mBeach Software. These periodic reports and certifications contained material misrepresentations and omissions pertaining to mBeach Software's business plan and Respondent's involvement in mBeach Software, including but not limited to Respondent's purported design, establishment, evaluation, and maintenance of disclosure controls and procedures and internal control over financial reporting.

10. Respondent signed other documents in furtherance of mBeach Software's sole purpose as a public vehicle for merger or acquisition, including board resolutions and management representation letters to auditors containing false statements related to the issuance of mBeach Software's shares, the accuracy of mBeach Software's disclosures, Respondent's knowledge of fraud involving mBeach Software, and the existence and nature of mBeach Software's disclosure controls and procedures and internal control over financial reporting.

11. Respondent took these various actions at the direction of mBeach Software's undisclosed control persons. Respondent received $10,000 upon the sale of mBeach Software as the flat fee agreed upon with the undisclosed control persons that had no correlation to Respondent's purported ownership of mBeach Software shares or the terms of the stock purchase agreement effectuating the change of control.

12. As a result of the conduct described above, Respondent willfully violated Section 13(b)(5) of the Exchange Act, which prohibits a person from knowingly circumventing or

knowingly failing to implement a system of internal accounting controls or knowingly falsifying any book, record or account described in Section 13(b)(2) of the Exchange Act.

13. As a result of the conduct described above, Respondent willfully violated Rule 13b2-1 under the Exchange Act, which prohibits a person from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act.

14. As a result of the conduct described above, Respondent willfully violated Rule 13b2-2 under the Exchange Act, which prohibits an officer or director of an issuer to make or cause to be made, or omit or cause another person to omit to state, a materially false or misleading statement to an accountant in connection with the preparation or filing of any document or report required to be filed with the Commission.

15. As a result of the conduct described above, Respondent violated Rule 15d-14 under the Exchange Act, which requires that the principal executive and principal financial officers of an issuer that files a report pursuant to Section 15(d) of the Exchange Act sign a certification that, among other things and based on their knowledge, the periodic report filed with the Commission does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading.

16. As a result of the conduct described above, Respondent violated Rule 15d-15 under the Exchange Act, which requires the management of an issuer that files reports pursuant to Section 15(d) of the Exchange Act to evaluate the effectiveness of the issuer's disclosure controls and procedures, and which requires the management of an issuer that either had been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act, or had previously filed an annual report, to evaluate the effectiveness of the issuer's internal control over financial reporting.

17. As a result of the conduct described above, Respondent caused violations by the undisclosed control persons of Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

18. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by the undisclosed control persons of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

19. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by mBeach Software of Section 13(b)(2)(A) of the Exchange Act, which requires that an issuer which is required to file reports pursuant to Section 15(d) of the Exchange Act make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

20. As a result of the conduct described above, Respondent aided and abetted and caused violations by mBeach Software of Section 13(b)(2)(B) of the Exchange Act, which requires that an issuer which is required to file reports pursuant to Section 15(d) of the Exchange Act devise and maintain a system of internal accounting controls.

21. As a result of the conduct described above, Respondent aided and abetted and caused violations by mBeach Software of Section 15(d) of the Exchange Act, Rules 12b-11, 12b-20, 15d-1, 15d-13 and 15d-14 thereunder and willfully aided and abetted and caused violations by mBeach Software of Rule 302 of Regulation S-T, which require that an issuer which has filed a registration statement which has become effective pursuant to the Securities Act file periodic information, documents, and reports as required pursuant to Section 13 of the Exchange Act, including quarterly reports on Form 10-Q and annual reports on Form 10-K, and that such reports be signed, contain such material information as may be necessary to make the required statements in light of the circumstances under which they are made not misleading, and include certifications signed by the issuer's principal executive and principal financial officers.

22. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by mBeach Software of Rule 13b2-1 under the Exchange Act, which prohibits a person from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act.

23. As a result of the conduct described above, Respondent aided and abetted and caused violations by mBeach Software of Rule 15d-15 under the Exchange Act, which requires an issuer that files reports pursuant to Section 15(d) of the Exchange Act to evaluate the effectiveness of the issuer's disclosure controls and procedures, and which requires an issuer that either had been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act, or had previously filed an annual report, to evaluate the effectiveness of the issuer's internal control over financial reporting.

Disgorgement and Civil Penalties

24. Respondent has submitted a sworn Statement of Financial Condition dated October 3, 2014 and other evidence, and has asserted his inability to pay disgorgement plus prejudgment interest or a civil penalty.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Gaffney'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. Respondent Gaffney cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Sections 10(b), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5) and 15(d) of the Exchange Act and Rules 10b-5, 12b-11, 12b-20, 13b2-1, 13b2-2, 15d-1, 15d-13, 15d-14 and 15d-15 promulgated thereunder, and Rule 302 of Regulation S-T.

B. Respondent Gaffney be, and hereby is:

> prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act; and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Respondent shall pay disgorgement of $10,000 which represents profits gained as a result of the conduct described herein, and prejudgment interest of $1,515.11, but that payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated October 3, 2014 and other documents submitted to the Commission. Based upon Respondent's sworn representations in his Statement of Financial Condition dated October 3, 2014 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

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

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.

Brent J. Fields
Secretary

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

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9747 / April 16, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74748 / April 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16493

In the Matter of

EDWARD T. FARMER

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 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 Edward T. Farmer ("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, and except as provided herein in Section V, 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[1] that:

Respondent

1. Respondent was the sole officer, director, and majority shareholder of We Sell for U Corp. ("We Sell for U"), a Florida corporation. Respondent, 68 years old, is a resident of Sarasota, Florida.

Other Relevant Entities and Persons

2. We Sell for U, incorporated in Florida on November 13, 2007, registered an offering of 4,000,000 shares of common stock pursuant to a registration statement effective as of March 7, 2008. We Sell for U's stated principal place of business was in Osprey, Florida. Effective as of December 30, 2008, We Sell for U underwent a change of control pursuant to a stock purchase agreement. We Sell for U had at least two undisclosed parents, promoters, and control persons ("undisclosed control persons") prior to that change of control.

Background

3. One of the undisclosed control persons approached Respondent for a business plan to be adopted, but never implemented, by a company whose sole purpose was to be sold as a public vehicle, and told Respondent that Respondent would be paid a flat fee upon the sale of the company. That company was soon incorporated as We Sell for U on November 13, 2007.

4. On January 25, 2008, We Sell for U filed a Form SB-2 registration statement seeking to register the offer and sale of 4,000,000 common shares in a $40,000 public offering, and amended its statement (designated as Form S-1/A) on March 4, 2008 and March 6, 2008 (together, the "Registration Statement"). The Registration Statement became effective as of March 7, 2008.

5. According to the Registration Statement and We Sell for U's other filings with the Commission, Respondent was the President, Director, Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer, majority shareholder, and sole member of management of We Sell for U. Respondent knew that he was designated to hold these various positions with respect to We Sell for U.

6. The Registration Statement and We Sell for U's other filings with the Commission materially misrepresented that Respondent had capitalized We Sell for U and controlled, and would continue to control, We Sell for U. Respondent knew at all material times that, to the contrary, We

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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.

Sell for U was capitalized, operated and otherwise controlled by the undisclosed control persons, none of whom was disclosed in any of We Sell for U's filings with the Commission.

7. The Registration Statement and We Sell for U's other filings with the Commission materially misrepresented that We Sell for U's business plan was "to develop and provide service offerings to facilitate auctions on eBay for individuals and companies who lack the eBay expertise and/or time to list/sell and ship items they wish to sell." Respondent took no actions toward any such business plan for We Sell for U. Respondent knew at all material times that We Sell for U had no purpose other than to engage in a merger or acquisition with an unidentified entity. Therefore, We Sell for U was an undisclosed "blank check company" as defined in Rule 419 under the Securities Act.

8. Respondent took no actions toward devising, designing, maintaining, or evaluating internal accounting controls, disclosure controls and procedures as defined in Rule 15d-15(e) under the Exchange Act ("disclosure controls and procedures"), or internal control over financial reporting as defined in Rule 15d-15(f) under the Exchange Act ("internal control over financial reporting") for We Sell for U.

9. We Sell for U filed Forms 10-Q on May 13, 2008, July 14, 2008, October 15, 2008, and October 23, 2008. Although Respondent did not expressly consent to the use of his electronic signature on these periodic reports and the accompanying certifications, Respondent received drafts and final versions of periodic reports containing certifications signed in his name prior to their filing and email confirmations from the Commission upon their filing. These periodic reports and certifications contained material misrepresentations and omissions pertaining to We Sell for U's business plan and Respondent's involvement in We Sell for U, including but not limited to Respondent's purported design, establishment, evaluation, and maintenance of disclosure controls and procedures and internal control over financial reporting.

10. Respondent signed other documents at the direction of the undisclosed control persons in furtherance of We Sell for U's sole purpose as a public vehicle for merger or acquisition, including board resolutions, documents in support of a Form 211 application filed with the Financial Industry Regulatory Authority (FINRA) and management representation letters to auditors containing false statements related to the issuance of We Sell for U's shares, the accuracy of We Sell for U's disclosures, Respondent's knowledge of fraud involving We Sell for U, and the existence and nature of We Sell for U's disclosure controls and procedures and internal control over financial reporting.

11. Respondent signed the stock purchase agreement dated December 30, 2008, by which all shares of We Sell for U common stock were sold to a third party to effectuate a change of control. This agreement contained materially false representations and warranties with respect to the accuracy of We Sell for U's filings with the Commission, We Sell for U's compliance in all material respects with all applicable laws and regulations (including specifically the Sarbanes-Oxley Act of 2002), and We Sell for U's disclosure controls and procedures and internal control over financial reporting.

12. Respondent took these various actions at the direction of We Sell for U's undisclosed control persons. Respondent received $35,000 upon the sale of We Sell for U as the flat fee agreed upon with one of the undisclosed control persons that had no correlation to Respondent's purported ownership of We Sell for U shares or the terms of the stock purchase agreement.

13. As a result of the conduct described above, Respondent willfully violated Section 13(b)(5) of the Exchange Act, which prohibits a person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls or knowingly falsifying any book, record or account described in Section 13(b)(2) of the Exchange Act.

14. As a result of the conduct described above, Respondent willfully violated Rule 13b2-1 under the Exchange Act, which prohibits a person from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act.

15. As a result of the conduct described above, Respondent willfully violated Rule 13b2-2 under the Exchange Act, which prohibits an officer or director of an issuer to make or cause to be made, or omit or cause another person to omit to state, a materially false or misleading statement to an accountant in connection with the preparation or filing of any document or report required to be filed with the Commission.

16. As a result of the conduct described above, Respondent violated Rule 15d-14 under the Exchange Act, which requires that the principal executive and principal financial officers of an issuer that files a report pursuant to Section 15(d) of the Exchange Act sign a certification that, among other things and based on their knowledge, the periodic report filed with the Commission does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading.

17. As a result of the conduct described above, Respondent violated Rule 15d-15 under the Exchange Act, which requires the management of an issuer that files reports pursuant to Section 15(d) of the Exchange Act to evaluate the effectiveness of the issuer's disclosure controls and procedures, and which requires the management of an issuer that either had been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act, or had previously filed an annual report, to evaluate the effectiveness of the issuer's internal control over financial reporting.

18. As a result of the conduct described above, Respondent caused violations by the undisclosed control persons of Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

19. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by the undisclosed control persons of Section 10(b) of the

Exchange Act and Rule 10b-5 promulgated thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

20. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by We Sell for U of Section 13(b)(2)(A) of the Exchange Act, which requires that an issuer which is required to file reports pursuant to Section 15(d) of the Exchange Act make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

21. As a result of the conduct described above, Respondent aided and abetted and caused violations by We Sell for U of Section 13(b)(2)(B) of the Exchange Act, which requires that an issuer which is required to file reports pursuant to Section 15(d) of the Exchange Act devise and maintain a system of internal accounting controls.

22. As a result of the conduct described above, Respondent aided and abetted and caused violations by We Sell for U of Section 15(d) of the Exchange Act, Rules 12b-11, 12b-20, 15d-13 and 15d-14 thereunder and willfully aided and abetted and caused violations by We Sell for U of Rule 302 of Regulation S-T, which require that an issuer which has filed a registration statement which has become effective pursuant to the Securities Act file periodic information, documents, and reports as required pursuant to Section 13 of the Exchange Act, including quarterly reports on Form 10-Q, and that such reports be signed, contain such material information as may be necessary to make the required statements in light of the circumstances under which they are made not misleading, and include certifications signed by the issuer's principal executive and principal financial officers.

23. As a result of the conduct described above, Respondent willfully aided and abetted and caused violations by We Sell for U of Rule 13b2-1 under the Exchange Act, which prohibits a person from directly or indirectly falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act.

24. As a result of the conduct described above, Respondent aided and abetted and caused violations by We Sell for U of Rule 15d-15 under the Exchange Act, which requires an issuer that files reports pursuant to Section 15(d) of the Exchange Act to evaluate the effectiveness of the issuer's disclosure controls and procedures, and which requires an issuer that either had been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act, or had previously filed an annual report, to evaluate the effectiveness of the issuer's internal control over financial reporting.

Disgorgement

25. Respondent has submitted a sworn Statement of Financial Condition dated October 15, 2014 and other evidence, and has asserted his inability to pay prejudgment interest on the disgorgement ordered herein.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Farmer'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. Respondent Farmer cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Sections 10(b), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5) and 15(d) of the Exchange Act and Rules 10b-5, 12b-11, 12b-20, 13b2-1, 13b2-2, 15d-13, 15d-14 and 15d-15 promulgated thereunder, and Rule 302 of Regulation S-T.

B. Respondent Farmer be, and hereby is:

> prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act; and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of $35,000 which represents profits gained as a result of the conduct described herein, and prejudgment interest of $7,816.50, but that payment of such amount (except for $35,000) is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated October 15, 2014 and other documents submitted to the Commission. The payment required by this Order shall be made 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 Edward Farmer 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 Glenn S. Gordon, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

D. 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.

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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9751 / April 17, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74753 / April 17, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31555 / April 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16498

In the Matter of **RUSSELL C. SCHALK, JR.** **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, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate 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"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act"), against Russell C. Schalk, Jr. ("Respondent" or "Schalk").

II.

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

Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order") and Notice of Hearing, as set forth below.

III.

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

Summary

From January 2007 to March 2012, Schalk violated Section 5(a) and 5(c) of the Securities Act in connection with unregistered offers and sales of at least $1,973,000 of the securities of Raintree Racing, LLC ("Raintree Racing"), and at least $362,000 of the securities of Raintree Thoroughbred Farm, Inc. ("Raintree Farm") to at least sixteen investors in at least six states. In connection with these sales, Schalk made material misrepresentations and failed to disclose material facts to investors concerning (i) the merits and risks associated with the investment, (ii) the speculative nature of the promised 20% return on investment, (iii) the safety of invested principal, and (iv) the financial condition of Raintree Racing. In addition, Schalk prepared Raintree Farm Private Placement Memoranda (PPMs), and prepared and enabled the distribution of account statements to investors that made material misrepresentations and omissions concerning the financial condition of Raintree Farm. Schalk also diverted at least $220,000 of Raintree Racing and Raintree Farm assets to his personal bank account. As a result of the conduct described above, investors lost $1,472,959.

Respondent

1. Schalk, 60 years old, resides in Hunt Valley, Maryland, and is currently employed by First Incentive Travel International as a Vice President of Sales. Schalk was the sole control person and a one third owner of Raintree Racing and has been, and is, the sole control person, as well as the President, Chief Executive Officer and Secretary-Treasurer of Raintree Farm.

Other Relevant Entities

2. Raintree Racing was created in 2007 as a Maryland limited liability company whose principal place of business was Towson, Maryland. Raintree Racing was engaged

[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.

in the purchase and sale of thoroughbred horses. Raintree Racing has never registered with the Commission and has never registered an offering of securities under the Securities Act. Raintree Racing has had essentially no business activity since early 2012.

3. A second owner of Raintree Racing ("Second Owner"), who was a one-third owner of Raintree Racing and a member of its Management Committee, was at relevant times an unregistered investment adviser to some investors in Raintree Racing and Raintree Farm.

4. Raintree Farm is a Delaware corporation which since 2002 has been engaged in the purchase, sale, and racing of thoroughbred horses. Raintree Farm has never registered with the Commission. In 2007 and 2010, Raintree Farm made filings pursuant to Securities Act Regulation D and Rule 506 thereunder for the offer and sale of its securities in private offerings. The common stock of Raintree Farm has never been publicly traded. Raintree Farm has had essentially no business activity since early 2012.

Facts

Misrepresentations and Omissions: Raintree Racing

5. From 2007 to 2010, Schalk and the Second Owner solicited nearly $2 million from certain investors in Raintree Racing. *See* Table I, below. While the Second Owner had direct contact with the investors, Schalk knew or was reckless in not knowing that Raintree Racing investors had been told they were making short-term principal protected loan-like investments in Raintree Racing.

TABLE I

Raintree Racing

Investments – 2007 to 2010

Investor	2007	2008	2009	2010	Total
1	$100,000	$0	$0	$0	$100,000
2	300,000	365,000	340,000	132,247	1,137,247
3	25,000	0	0	0	25,000
4	0	0	0	15,000	15,000
5	25,000	0	0	1,000	26,000
6	25,000	25,000	0	1,000	51,000
7	0	0	30,000	1,500	31,500
8	0	100,000	32,000	3,000	135,000
9	0	0	30,000	0	30,000
10	0	0	130,000	0	130,000
11	0	0	0	75,000	75,000
12	0	0	128,000	0	128,000
13	0	2,000	0	0	2,000
14	25,000	25,000	0	0	50,000
15	0	25,000	0	0	25,000
16	10,000	0	0	3,000	13,000
Total	$510,000	$542,000	$690,000	$231,747	$1,973,747

6. Specifically, Raintree Racing investors identified in Table I were provided agreements stating that (i) funds were to be invested for a fixed period not to exceed one year, (ii) invested principal would be returned at the maturity date, and (iii) investors would receive an annualized return of 20% on their investment. Schalk signed one or more of these agreements on behalf of Raintree Racing. In addition, Schalk was copied on multiple emails sent to investors attaching agreements and asking that investors execute the agreements and return them to Schalk.

7. Consistent with the representation that the Raintree Racing investments were akin to principal-protected loans, beginning in 2007, investors received from Raintree Racing checks accompanied by cover letters, both of which had been signed by Schalk and indicated the checks to be interest payments. *See* Table II, below. Furthermore, Schalk knew that from 2007 until 2010, Form 1099 INT tax documents provided to investors represented payments to Raintree Racing investors as "interest" payments.

TABLE II

Raintree Racing

Interest and Principal Payments to Investors – 2007 to 2010[2]

Investor	2007	2008	2009	2010	Net Loss[3]
1	$7,637	$110,000	$0	$0	($17,637)
2	4,812	75,418	241,379	78,367	737,271
3	1,250	28,750	0	0	(5,000)
4	0	0	0	(495)	14,505
5	0	5,000	5,000	1,500	14,500
6	0	6,834	31,569	1,500	11,097
7	0	0	4,500	1,500	25,500
8	0	57,095	5,577	4,600	67,728
9	4,583	7,091	8,937	4,100	5,289
10	0	0	3,197	14,592	112,211
11	0	0	0	0	75,000
12	0	0	6,400	5,650	115,950
13	0	0	0	0	2,000
14	3,153	7,228	10,000	5,000	24,619
15	0	2,596	5,000	2,500	14,904
16	8,333	12,000	12,000	3,000	(22,333)
Total	$29,768	$312,012	$333,559	$122,804	$1,175,604

8. While investors were told that their investment principal was not at risk, in fact it was. Schalk, who controlled both Raintree Racing and Raintree Farm, regularly transferred funds from Raintree Racing to Raintree Farm. Specifically, from 2007 through 2010, at least $668,000 was transferred from Raintree Racing to Raintree Farm. *See* Table III, below. These funds were used to pay expenses of Raintree Farm. Not only was this practice contrary to what investors were told about how their funds would be used, but the partnership documents organizing Raintree Racing did not authorize such transfers.

[2] Amounts presented include repayment of principal in 2008 of $100,000 to investor 1, $25,000 to investor 3, and $45,000 to investor 8, and principal repayments in 2009 of $80,000 to investor 2 and $25,000 to investor 6.
[3] Represents total investment by each investor (*see* Table I, above) less interest payments and repayment of principal.

TABLE III

Transfers from Raintree Racing to Raintree Farm – 2007 to 2010

	2007	2008	2009	2010	Total
Transfers from Raintree Racing	$143,000	$219,294	$151,279	$159,125	$672,698
Withdrawals from Raintree Racing	87,500	17,500	42,500	0	147,500
Total transfers from Raintree Racing to Raintree Farm	230,500	236,794	193,779	159,125	820,198
Less: Transfers from Raintree Farm to Raintree Racing	(41,000)	(85,750)	(7,038)	(17,750)	(151,538)
Net Transfers	$189,500	$151,044	$186,741	$141,375	$668,660

9. As the control person of Raintree Racing, Schalk knew or was reckless in not knowing that Raintree Racing funds should not be transferred to Raintree Farm. In an e-mail to Schalk dated June 10, 2010, the Second Owner questioned why Raintree Racing money was being used to cover Raintree Farm expenses: "Has the farm reimbursed RR for these expenses thus far? If not, when? The farm should be operating as a separate entity in my mind." In a reply e-mail, Schalk falsely denied that Raintree Racing funds were used to fund Raintree Farm expenses.

10. Schalk knew that Raintree Racing did not have cash flow or other resources to pay Raintree Racing investors the promised 20% interest and return their principal. Schalk knew that Raintree Racing had net losses from operations in fiscal years 2009 through 2011 and had minimal income in earlier years. *See* Table IV, below. Schalk knew that Raintree Racing had no assets other than investor funds, and was dependent on infusion of funds from investors in order to continue operations. Raintree Racing ultimately suspended operations effective December 31, 2012.

TABLE IV

Raintree Racing

Operating Results – 2007 to 2012[4]

	2007	2008	2009	2010	2011	2012
Gross receipts	$69,731	$255,000	$205,000	$58,000	$0	$0
Less: interest	(38,105)	(174,024)	(255,431)	(128,696)	0	0
Less: other expenses	(8,749)	(9,267)	(2,255)	(7,637)	(2,250)	(910)
Net income (loss)	$22,877	$71,709	($52,686)	($78,333)	($2,250)	($910)

11. E-Mails from Schalk to the Second Owner illustrate Raintree Racing's lack of resources. In an e-mail to the Second Owner dated February 12, 2010, Schalk said: "I am in desperate need of some cash for the next 30 days or so. Is there anything you can do to help." In an e-mail to the Second Owner dated March 4, 2010, Schalk said: "I have over $20K of expenses past due on the farm. I am trying all available resources to come up with some money, even if it is a short term loan for 30-45 days." In an e-mail to the Second Owner dated May 13, 2010, Schalk said: "I cannot pay the additional help tomorrow, which is bad enough, and there is no way that can go beyond Monday. . . I had dunning messages from the farm in [sic] Delaware, which will not release the horses until the bill gets paid . . . ."

12. Investors were never provided financial information sufficient to understand the true financial condition of Raintree Racing.

13. The misstatements and omissions described above relating to how invested funds were used, the risks associated with the investment and the financial condition of Raintree Racing were material to investors.

<u>Misrepresentations and Omissions: Raintree Farm</u>

14. In addition to the loan agreements documenting their investment in Raintree Racing as described above, Raintree Racing investors identified in Table I also received shares of Raintree Farm common stock, purportedly as "bonus" collateral for their investment in Raintree Racing. Investors were asked to submit Subscription Agreements in connection with their receipt of Raintree Farm shares. Schalk signed those agreements on behalf of Raintree Farm. In addition, in at least three instances during the period 2007 to 2011, as part of a $2.5 million Raintree Farm

[4] As presented in Raintree Racing tax returns.

offering, at least three persons purchased Raintree Farm shares directly, in the aggregate amount of $362,500, paying $5.00 per share. *See* Table V, below. From 2007 through 2010, these investors received limited interest and principal payments. *Id.*

TABLE V

Raintree Farm

Investments – 2007 to 2011

Investor	2007	2008	2009	2010	2011	Total Investment
8	$85,000	$25,000	$30,000	$19,500	$0	$159,500
9	0	0	0	11,000	4,000	15,000
10	0	130,000	29,500	28,500	0	188,000
Total	$85,000	$155,000	$59,500	$59,000	$4,000	$362,500

Interest and Principal Payments to Investors – 2007 to 2010

Investor	2007	2008	2009	2010	Net Loss[5]
8	$3,336	$29,000	$3,126	$925	$123,113
9	0	0	0	0	15,000
10	5,000	19,083	4,400	275	159,242
Total	$8,336	$48,083	$7,526	$1,200	$297,355

15. Schalk assisted in the preparation of Raintree Farm PPMs dated July 1, 2007, and March 1, 2010, including providing information contained in the PPMs.

16. The Raintree Farm PPMs did not disclose the following material facts that were known by Schalk: (i) Raintree Farm operated at a material net loss since its inception in 2002 (*see* Table VI, below); (ii) Raintree Farm had minimal assets (*id.*); and (iii) Raintree Racing assets were funding Raintree Farm's operations (*see* Tables III and V, above). Each of these facts would have been important to an investor in deciding whether to invest in Raintree Farm.

[5] Represents total investment by investor (*see* Table immediately above) less interest payments and repayment of principal.

TABLE VI [6]

Raintree Farm

Operating Results – 2007 to 2012

	2007	2008	2009	2010	2011	2012
Gross receipts	$16,386	$53,512	$162,666	$44,685	$21,094	$10,220
Less: expenses	(132,720)	(145,232)	(198,649)	(146,886)	(89,285)	(71,866)
Less: depreciation	(13,408)	(3,692)	(58,598)	(26,083)	0	0
Less: interest	0	0	(746)	0	0	0
Net income (loss)	($129,742)	($95,412)	($95,327)	($128,284)	($68,181)	($61,646)

Assets and Equity – 2007 to 2012

	2007	2008	2009	2010	2011	2012
Assets	$46,323	$70,900	$22,339	$17,933	$3,422	$2,745
Equity	($574,363)	($673,307)	($736,112)	($867,533)	($936,384)	($995,548)

17. Without any factual basis for the claim, in late 2012 and early 2013, Schalk prepared and distributed to Raintree Farm investors account statements which stated that Raintree Farm's net asset value per share was $3.34. At the time Schalk valued the Raintree Farm shares, he knew that the shares had little or no value because he knew that Raintree Farm had minimal assets, had incurred continuing material net losses from at least 2007, had essentially no business activity in 2012, and had no viable prospect of resuming operations. *See* Table VI, above.

<u>Misappropriation of Funds</u>

18. From 2007 to 2011, Schalk diverted at least $220,000 from Raintree Farm and Raintree Racing bank accounts to his personal bank account without the knowledge or authorization of Raintree Farm and Raintree Racing investors. *See* Table VII, below.

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[6] As reported on tax returns for Raintree Farm.

TABLE VII

Raintree Racing and Raintree Farm

Funds Diverted by Schalk – 2007 to 2011

	2007	2008	2009	2010	2011	Total
Transfers from Raintree Racing	$44,298	$44,000	$23,668	$7,902	$1,125	$120,993
Withdrawals from Raintree Racing	22,500	6,125	17,000	0	0	45,625
Transfers from Raintree Farm	21,500	42,000	32,000	17,000	18,750	131,250
Withdrawals from Raintree Farm	5,000	0	0	0	0	5,000
Total Funds Diverted	93,298	92,125	72,668	24,902	19,875	302,868
Less: Transfers from Schalk to Raintree Racing	0	(5,000)	(1,000)	(2,500)	0	(8,500)
Less: Transfers from Schalk to Raintree Farm	(14,515)	(5,968)	(7,030)	(22,071)	(24,246)	(73,830)
Net Funds Diverted	$78,783	$81,157	$64,638	$331	($4,371)	$220,538

Unregistered Offerings – Raintree Racing

19. From 2007 to 2011, Schalk, via interstate commerce or the mails, engaged in the offer and sale of nearly $2 million of securities of Raintree Racing to at least sixteen investors in at least six states without a filed or effective registration statement for the offer and sale of these securities (*see* Table I, above).

20. Offers and sales of securities made via interstate commerce or the mails require registration unless they qualify for an exemption. Raintree Racing did not register any offering with the Commission, nor did it file any notices with the Commission claiming to rely on any exemption. In any event, the offers and sales of Raintree Racing securities described hereinabove did not qualify for exemption from registration.

21. In particular, the Raintree Racing offering did not comply with the exemption under Section 4(a)(2) of the Securities Act. Schalk, as the control person of Raintree Racing, offered and sold Raintree Racing securities to investors who did not have the knowledge and experience in financial and business matters, including experience in thoroughbred horse operations, to make them capable of evaluating the merits and risks of investments in Raintree Racing securities, and these unsophisticated investors did not have access to the type of information that would have been available in a registered offering.

22. The Raintree Racing offering also did not comply with any of the safe harbors in Rules 504, 505 and 506 of Regulation D under the Securities Act. First, Rule 504 was not available because the offering amount exceeded $1 million. Second, Rules 505 and 506 were not available because some Raintree Racing investors did not have the income or assets necessary to qualify as accredited investors as defined in Rule 501(a) of Regulation D, and these unaccredited investors were not provided with the non-financial and financial information specified in Rule 502(b) of Regulation D, including an audited balance sheet. Rule 506 was also not available because some of the unaccredited investors were not sophisticated, as required by Rule 506(b) of Regulation D.

Unregistered Offerings – Raintree Farm

23. In connection with the sale of the Raintree Racing securities described in paragraph 20, Schalk issued "bonus" shares of Raintree Farm common stock to Raintree Racing investors.

24. Pursuant to the definition of "sale" in Securities Act Section 2(a)(3), those "bonus" shares are conclusively presumed to constitute a part of the investors' purchase and to have been offered and sold for value. Therefore, the issuance of such shares constitutes a "sale" of Raintree Farm securities for the purposes of Section 5 of the Securities Act.

25. In addition, during the same 2007 to 2011 period, Schalk, via interstate commerce or the mails, engaged in the offer and sale of at least $362,500 in the common stock of Raintree Farm to at least three investors. *See* Table V, above.

26. In 2007 and 2010, Raintree Farm filed Notices of Sales of Securities with the Commission pursuant to Rule 506 of Regulation D, each of which related to an offering of $2.5 million of Raintree Farm stock. In the Notices, Raintree Farm purported to rely on an exemption pursuant to Rule 506 of Regulation D under the Securities Act, and represented that sales would be made only to accredited investors. While the notices were filed in 2007 and 2010, the offerings went beyond that period.

27. Schalk engaged in the offer and sale of Raintree Farm shares to persons who did not qualify as accredited investors. As described above, several Raintree Racing investors who

were issued Raintree Farm shares were unaccredited. In addition, some Raintree Farm investors reflected in Table V, above, did not qualify as accredited investors.

28. Schalk knew or should have known that shares of Raintree Farm common stock were sold to investors who did not qualify as accredited investors. For example, Raintree Farm investors were sent subscription agreements. On several occasions, incomplete subscription agreements were returned without providing the information required to assess whether the investor qualified as an accredited investor. Schalk failed to take steps necessary to form a reasonable belief that those investors were accredited and, if they were not, that they had the knowledge and experience in financial and business matters, including experience in thoroughbred horse operations, to make them capable of evaluating the merits and risks of investment in Raintree Farm securities.

29. Also, the unaccredited Raintree Farm investors were not provided with the non-financial and financial information specified in Rule 502(b) of Regulation D, including at least an audited balance sheet. For the same reasons outlined in paragraphs 20 through 22 above, no other exemptions were available for this offering.

Violations

30. As a result of the conduct described above, Schalk willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the offer and sale of securities by any person directly or indirectly through the use of any means of interstate commerce without a registration statement having been filed and being in effect as to those securities.

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

IV.

Respondent undertakes to the following: In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent: (i) agrees to appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) appoints Respondent's attorney of record as agent to receive service of such notices and subpoenas; and (iv) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

V.

Pursuant to this Order, Respondent agrees to disgorgement of $1,472,959, prejudgment interest of $280,271.55, and a third tier civil penalty of $1,600,000.00 based on the number of investors, and further agrees to additional proceedings to determine his ability to pay. In connection with such additional proceedings: (a) Respondent agrees that he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order, including amounts lost by investors and misappropriated by Respondent as stated in this Order; (c) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine Respondent's ability to pay on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence. Respondent reserves the right to contest his ability to pay the disgorgement, civil penalties, and prejudgment interest ordered.

VI.

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

Accordingly, pursuant to Section 8A of the Securities Act, 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Schalk shall cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

B. Respondent Schalk shall be, and hereby is, prohibited from serving or 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 Schalk shall be, and hereby 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; and

D. Respondent Schalk shall be found liable for disgorgement of $1,472,959.00, a third tier civil penalty of $1,600,000.00 based on the number of investors, and prejudgment interest of $280,271.55, subject to additional proceedings to determine his ability to pay.

VII.

IT IS ORDERED that Respondent's ability to pay the amounts set forth in Section V hereof shall be determined by 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, and that the Administrative Law Judge may determine Respondent's ability to pay in additional proceedings on motion of the Commission on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

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

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9752 / April 17, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74754 / April 17, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4064 / April 17, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31556 / April 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16499

In the Matter of JOSEPH JOHN LABADIA 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 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 Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Joseph John Labadia ("Respondent" or "Labadia").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, 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

From January 2007 through 2012, Labadia made material misrepresentations and failed to disclose material facts to investors in connection with unregistered offers and sales of at least $1,973,000 of the securities of Raintree Racing, LLC ("Raintree Racing"), and at least $362,000 of the securities of Raintree Thoroughbred Farm, Inc. ("Raintree Farm") to at least sixteen investors in at least six states. At least $1,137,000 of the $1,973,000 invested in Raintree Racing securities consisted of Labadia's unauthorized investment of funds of Atlanta Rehab Capital, LLC ("Atlanta Rehab") a real estate company in which he was the managing principal. Five of the approximately nine Atlanta Rehab investors were also advisory clients of Labadia. Labadia breached his fiduciary duty to these clients by charging them advisory fees based on inflated portfolio values that overstated the value of investments in Raintree Racing and by making misrepresentations.

[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. Respondent, 45 years old, is a resident of Neptune Beach, Florida, and is currently self-employed. Respondent filed for bankruptcy in May 2011. Respondent was a one-third owner, and a Member of the Management Committee of Raintree Racing, and was the President and control person of Atlanta Rehab. Respondent was at relevant times an unregistered investment adviser to persons who invested in Raintree Racing, Raintree Farm and Atlanta Rehab. Respondent holds the Chartered Financial Analyst (CFA) designation, as wells as Series 7, 63 and 65 securities licenses. In July 2003, Respondent voluntarily terminated his association with a broker-dealer and thereafter did not register with another broker-dealer.

Other Relevant Entities

2. Raintree Racing was created in 2007 as a Maryland limited liability company whose principal place of business was Towson, Maryland. Raintree Racing was engaged in the purchase and sale of thoroughbred horses. Raintree Racing has never registered with the Commission and has never registered an offering of securities under the Securities Act. Raintree Racing has had essentially no business activity since early 2012.

3. Raintree Farm is a Delaware corporation which since 2002 has been engaged in the purchase, sale, and racing of thoroughbred horses. Raintree Farm has never registered with the Commission. In 2007 and 2010, Raintree Farm made filings pursuant to Securities Act Regulation D and Rule 506 thereunder for the offer and sale of its securities in private offerings. The common stock of Raintree Farm has never been publicly traded. Raintree Farm has had essentially no business activity since early 2012.

4. Atlanta Rehab was a Georgia limited liability company with its principal place of business in Atlanta, Georgia. The company is no longer in business but was principally engaged in the business of real estate lending during its existence.

Facts

Misrepresentations In Connection with Raintree Racing

5. From 2007 to at least 2010, Labadia solicited at least $1,973,000 from investors in Raintree Racing (*see* Table I)[2]. Labadia told the investors, verbally and in writing,

[2] In order to maintain investor confidentiality, the actual names of investors are not listed. Amounts invested and investor balances were based on information in stock ledgers and bank statements. The payments on this table include repayments in 2008 of $100,000 to investor 1, $25,000 to investor 3, and

they were making short-term principal protected investments in Raintree Racing that he characterized as "loans." In one June 14, 2008 e-mail, Labadia told an investor "The horse farm is doing remarkably well. As a result, we have a lot more cash reserves and are raising capital to expand. Current rate of return is 20% per year. This is extremely low risk." In a separate June 2008 email, and one from April 2009, Labadia informed investors that Raintree Racing's purchase and sale of thoroughbred horses was conducted simultaneously, and thus there is only a "tiny" bit of risk in Raintree Racing's operations. Investors in Raintree Racing were to be provided "bonus" shares of Raintree Farm as "collateral."

TABLE I

Raintree Racing

Investments – 2007 to 2010

Investor	2007	2008	2009	2010	Total
1	$100,000	$0	$0	$0	$100,000
2	300,000	365,000	340,000	132,247	1,137,247
3	25,000	0	0	0	25,000
4	0	0	0	15,000	15,000
5	25,000	0	0	1,000	26,000
6	25,000	25,000	0	1,000	51,000
7	0	0	30,000	1,500	31,500
8	0	100,000	32,000	3,000	135,000
9	0	0	30,000	0	30,000
10	0	0	130,000	0	130,000
11	0	0	0	75,000	75,000
12	0	0	128,000	0	128,000
13	0	2,000	0	0	2,000
14	25,000	25,000	0	0	50,000
15	0	25,000	0	0	25,000
16	10,000	0	0	3,000	13,000
Total	$510,000	$542,000	$690,000	$231,747	$1,973,747

6. In addition, Raintree Racing investors identified in Table I were provided written agreements stating that (i) funds were to be invested for a fixed period not to exceed one year, (ii) invested principal would be returned at the maturity date, and (iii) investors would receive an annualized return of 20% on their investment.

$45,000 to investor 8. The payments include principal repayments in 2009 of $80,000 to investor 2 and $25,000 to investor 6.

7. While Labadia may have initially believed in the safety of funds invested in Raintree Racing, ultimately he knew, or was reckless in not knowing, that investment in Raintree Racing involved significant risk because Raintree Racing did not have cash flow or other resources to pay Raintree Racing investors the promised 20% interest and return their principal. Labadia revealed his understanding of Raintree Racing's cash flow issues in several emails to the Raintree Racing control person. In an e-mail dated March 10, 2009, Labadia stated he did not know where the funds would come from to cover full interest payments then due Raintree Racing investors. In an e-mail dated June 9, 2010, Labadia said: "I am still upset about how much I've raised since November and we still need cash." Further, in March 2010, when Raintree Racing lacked adequate cash flow, Labadia offered some prospective investors 40% interest for "emergency capital." In May 2010, Labadia offered a return of $6,750 on an investment of $75,000 returnable in six weeks, but with an understanding the investor would get paid in four weeks. Labadia knew or was reckless in not knowing that Raintree Racing had significant cash flow problems, and was dependent on infusion of funds from investors in order to continue operations that were finally suspended effective December 31, 2012.

8. Moreover, Labadia knew that at certain times Raintree Racing funds were being diverted to fund operations of Raintree Farm. Labadia received an April 3, 2008 email from the Raintree Racing control person that stated, "Things are quite critical at the moment and I need to take some of my funds from Raintree Racing and move to the farm [Raintree Farm]." In a June 10, 2010 email to the Raintree Racing control person, Labadia wrote, "It was my understanding all along that the money raised for Raintree Racing would be used solely for the purpose of conducting deals, not covering everyday expenses. Has the farm reimbursed RR for these expenses thus far? If not, when? The farm should be operating as a separate entity in my mind." Labadia did not disclose to Raintree Racing investors that Raintree Racing's funds were being used to fund Raintree Farm operations.

9. The misstatements and omissions described above relating to how invested funds were used, the risks associated with the investment and the financial condition of Raintree Racing were material to investors.

<u>Misrepresentations in Connection with Atlanta Rehab</u>

10. Labadia led Atlanta Rehab investors to believe that their funds were invested in Atlanta, GA real estate. In fact, following the collapse of the Atlanta real estate market, Labadia made an investment of at least $1,137,000 of Atlanta Rehab investor funds into Raintree Racing without authorization, and without disclosing the investment.

11. Moreover, Labadia prepared and provided to Atlanta Rehab investors account statements, until at least August 2011, that valued Atlanta Rehab's investment in Raintree Racing at the original principal amount invested despite the fact that a substantial portion of Atlanta Rehab funds were invested in Raintree Racing. Raintree Racing had net losses from operations in fiscal years 2009 through 2011 and minimal net income in earlier years. Raintree Racing finally suspended operations as of December 31, 2012.

Breach of Fiduciary Duty As An Investment Adviser

12. Labadia was, during relevant times, an unregistered investment adviser who breached his fiduciary duty to his clients. As described above, Labadia made material misrepresentations to investors in Raintree Racing and Atlanta Rehab. Five of those investors were also advisory clients of Labadia.

13. Labadia charged these clients advisory fees which were calculated at amounts ranging from .75% to 1% of net asset value per annum, resulting in client advisory fee payments from 2007 to 2010 of at least $48,337. Labadia provided account statements to advisory clients that billed clients for advisory services based upon assets under management, and which Labadia knew, or was reckless in not knowing, materially overstated the value of investments in Raintree Racing.

Unregistered Offers and Sales – Raintree Racing

14. From 2007 to 2010, Labadia via interstate commerce or the mails, engaged in the offer and sale of at least $1,973,000 of securities of Raintree Racing to at least sixteen investors in at least six states without a filed or effective registration statement for the offer and sale of these securities (see Table I, above).

15. Offers and sales of securities made via interstate commerce or the mails require registration unless they qualify for an exemption. Raintree Racing did not register any offering with the Commission, nor did it file any notices with the Commission claiming to rely on any exemption. In any event, the offers and sales of Raintree Racing securities described hereinabove did not qualify for exemption from registration.

16. In particular, the Raintree Racing offering did not comply with the exemption under Section 4(a)(2) of the Securities Act. Labadia sold Raintree Racing securities to investors who did not have the knowledge and experience in financial and business matters, including experience in thoroughbred horse operations, to make them capable of evaluating the merits and risks of investments in Raintree Racing securities, and these unsophisticated investors did not have access to the type of information that would have been available in a registered offering. Moreover, the investors did not have the income or assets necessary to qualify them as accredited investors pursuant to Securities Act, Regualtion D and Rule 501.

17. The Raintree Racing offering also did not comply with any of the safe harbors in Rules 504, 505 and 506 of Regulation D under the Securities Act. First, Rule 504 was not available because the offering amount exceeded $1 million. Second, Rules 505 and 506 were not available because some Raintree Racing investors did not have the income or assets necessary to qualify as accredited investors as defined in Rule 501(a) of Regulation D, and these unaccredited investors were not provided with the non-financial and financial information specified in Rule 502(b) of Regulation D, including an audited balance sheet. Rule 506 was also not available because some of the unaccredited investors were not sophisticated, as required by Rule 506(b) of Regulation D.

Unregistered Offers and Sales – Raintree Farm

18. Labadia offered and sold at least $362,000 in the stock of Raintree Farm to at least three investors during the period 2007 through 2011. The Raintree Farm stock was neither registered, nor did it qualify for an exemption, although it was offered via interstate commerce or the mails.

19. In 2007 and 2010, Raintree Farm filed Notices of Sales of Securities with the Commission pursuant to Rule 506 of Regulation D, each of which related to an offering of $2.5 million of Raintree Farm stock. In the Notices, Raintree Farm purported to rely on an exemption pursuant to Rule 506 of Regulation D under the Securities Act, and represented that sales would be made only to accredited investors. While the notices were filed in 2007 and 2010, the offerings went beyond that period.

20. Labadia also engaged in the offer and sale of Raintree Farm shares to persons who did not qualify as accredited investors. The Raintree Farm offering did not comply with the exemption under Section 4(a)(2) of the Securities Act. Labadia sold Raintree Farm securities to investors who did not have the knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of investments in Raintree Farm securities, and these unsophisticated investors did not have access to the type of information that would have been available in a registered offering.

21. And because the Raintree Farm Notices of Sales of Securities filed with the Commission pursuant to Regulation D and Securities Act Rule 506 each offered $2.5 million of Raintree Farm stock, but inconsistently was not sold only to accredited investors, the offering failed to comply with any of the safe harbors in Rules 504, 505 and 506 of Regulation D under the Securities Act. First, Rule 504 was not available, because the offering amount exceeded $1 million. Second, Rules 505 and 506 were not available, because (i) some Raintree Farm investors did not have the income or assets necessary to qualify as accredited investors as defined in Rule 501(a) of Regulation D, and Labadia knew these investors were not accredited.

Violations

22. As a result of the conduct described above, Labadia willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the offer and sale of securities by any person directly or indirectly through the use of any means of interstate commerce without a registration statement having been filed and being in effect as to those securities.

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

24. As a result of the conduct described above, Labadia willfully violated Sections 206(1) and 206(2) of the Advisers Act which prohibits investment advisers from defrauding any client or prospective client.

Disgorgement and Civil Penalties

25. Respondent has submitted a sworn Statement of Financial Condition dated January 20, 2014, a sworn Verification dated June 23, 2014, and other evidence, and has asserted his inability to pay disgorgement plus prejudgment interest.

26. Respondent has submitted a sworn Statement of Financial Condition dated January 20, 2014, a sworn Verification dated June 23, 2014, and other evidence, and has asserted his inability to pay a civil penalty.

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 Labadia's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

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

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

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

Prohibited from serving or 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 change Act.

Respondent shall pay disgorgement of $48,337 plus prejudgment interest of $4,797.77 but that payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated January 20, 2014, his Verification dated June 23, 2014, and other evidence, submitted to the Commission.

Based upon Respondent's sworn representations in his Statement of Financial Condition dated January 20, 2014, his Verification dated June 23, 2014, and other evidence, submitted to the Commission, the Commission is not imposing a penalty against Respondent.

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, prejudgment interest and a civil penalty. No other issue shall be considered 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, prejudgment interest and a civil penalty should not be ordered; (3) contest the amount of disgorgement, prejudgment interest and civil penalty to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74757 / April 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16500

In the Matter of **Charles Duane Lewis,** **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 Charles Duane Lewis ("Lewis" 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 contained in Sections III.2 through III.5, below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the 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. Lewis, 59 years old, resides in La Mesa, California. From September 1999 through July 2010, Lewis was a registered representative of H.D. Vest Investment Securities, Inc., d/b/a H.D. Vest Investment Services ("H.D. Vest"), a broker-dealer registered with the Commission.

2. On November 3, 2010, Lewis pleaded guilty, in the Superior Court of the County of San Diego, California, and was convicted of theft from an elder, in violation of California Penal Code § 368(d), and fraudulent appropriation of funds, in violation of California Penal Code § 508, in a criminal action titled *The People of the State of California v. Charles Duane Lewis,* Court No. CE303319. On February 14, 2011, he was sentenced to three years of imprisonment and ordered to pay restitution in the amount of $332,661.12.

3. The counts of the criminal information to which Lewis pleaded guilty alleged, *inter alia*, that, between December 2007 and May 2010, Lewis fraudulently appropriated, for his own personal use, funds in excess of $950 from the account of an elderly H.D. Vest customer.

4. On April 29, 2013, Lewis pleaded guilty in the Superior Court of the County of San Diego, California and was convicted of fraudulent appropriation of funds, in violation of California Penal Code § 508, in a criminal action titled *The People of the State of California v. Charles Duane Lewis*, No. CE327099. As a result, Lewis was incarcerated from April 2013 through November 2013 and ordered to pay restitution in the amount of $399,391.24.

5. The counts of the criminal information to which Lewis pleaded guilty alleged, *inter alia*, that, between October 2003 and May 2011, Lewis, acting as trustee, fraudulently appropriated, for his own personal use, funds in excess of $950 from a family trust that was also an H.D. Vest customer.

6. On September 12, 2013, the Financial Industry Regulatory Authority ("FINRA") issued a consent order ("FINRA Order") in an administrative action entitled *Department of Enforcement v. Charles Duane Lewis*, Disciplinary Proceeding No. 2010023492301. The FINRA Order barred Lewis from associating with any FINRA member in any capacity.

7. The FINRA Order found that Lewis provided accounting and financial services through his company, Fletcher Hills Tax Service, to an H.D. Vest customer who was in her eighties during the time of the misconduct. FINRA alleged that, between December 2007 and May 2010, Lewis obtained a power of attorney over the H.D. Vest customer and wrote 61 checks from the customer's account to himself, Fletcher Hills Tax Service, and a friend for a combined total of $550,495.74. In connection with the FINRA Order, Lewis consented, without admitting or denying FINRA's allegations, to the entry of findings that he violated NASD Rules 2330(a) and 2110 and FINRA Rules 2150 and 2010, which prohibit persons associated with a FINRA member from making an improper use of a customer's funds and require a person associated with a member

to observe high standards of commercial honor and just and equitable principles of trade when conducting business.

IV.

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

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

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

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar Dissented as to the penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74765 / April 20, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15992

In the Matter of MARC SHERMAN Respondent.	ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to issue this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") as to Marc Sherman ("Respondent" or "Sherman").

II.

Following the institution of these proceedings on July 30, 2014, Respondent submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

A. SUMMARY

1. During its 2008 fiscal year and continuing up to its filing for Chapter 11 bankruptcy on July 2, 2009 (the "relevant period"), QSGI Inc. ("QSGI" or the "Company") was a reseller of and maintenance services provider for used computer equipment. Sherman, who during the relevant period served as QSGI's Chief Executive Officer and Chairman, was aware of deficiencies in and the circumvention of internal controls for inventory and the resulting falsification of the Company's books and records. Sherman withheld this information from the Company's external auditors in connection with their audit of the financial statements for the fiscal year ended December 31, 2008 and review of the financial statements for the quarter ended March 31, 2009, and made affirmative material misrepresentations and statements that were materially misleading as a result of his omission of information in management representation letters to the auditors about the design, maintenance, and operation of internal controls. Further, Sherman signed a Form 10-K and a Form 10-K/A for the 2008 fiscal year, each containing a management's report on internal control over financial reporting ("ICFR"), as required by Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act") and Exchange Act Rule 13a-15(c), which falsely represented that he, in his capacity as CEO, had participated in assessing the effectiveness of the Company's ICFR. Sherman also signed certifications required under Section 302 of the Sarbanes-Oxley Act and Rule 13a-14 of the Exchange Act included in filings with the Commission falsely representing that he had evaluated ICFR and, based on this evaluation, disclosed all significant deficiencies to the auditors. The certifications were attached to the 2008 Forms 10-K and 10-K/A, and to the first quarter 2009 Form 10-Q filed with the Commission, which Sherman also signed.

B. RESPONDENT

2. Sherman, age 51 and a resident of West Palm Beach, Florida, founded QSGI in 2001. He has since served as QSGI's CEO and Chairman of its Board of Directors. After the Company filed for bankruptcy, he also signed a Form 10-K/A for the fiscal year ended December 31, 2008 filed with the Commission in July 2010 in the capacity of Chief Financial Officer and Chief Accounting Officer.

C. RELEVANT ENTITY

3. QSGI, Inc., incorporated in 1967 in Delaware under a different name and headquartered during the relevant period in West Palm Beach, Florida, is engaged in the business of purchasing, refurbishing, selling, and servicing used computer equipment, parts and mainframes. On May 4, 2011, the U.S. Bankruptcy Court for the Southern District of Florida, West Palm Beach Division, confirmed QSGI's plan of reorganization pursuant to which, effective June 17, 2011, the corporate shell merged with a private company which had been founded by Sherman and others. During the relevant period, the Company's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and quoted on the OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc.

D. FACTS

Sherman's Awareness of Deficiencies in and Circumvention of Inventory Controls

4. During the relevant period, QSGI maintained inventory principally at facilities in New Jersey and Minnesota. The New Jersey inventory, which comprised 50% of the Company's reported gross inventory and 55% of its reported net inventory, after reduction for reserves, as of the close of its fiscal year ended December 31, 2008, was comprised of laptops, monitors, and other consumer electronics and components. The Minnesota inventory, which comprised 40% of QSGI's reported gross inventory and 35% of its reported net inventory, after reduction for reserves, as of the close of QSGI's 2008 fiscal year, was comprised chiefly of servers, mainframes, and component parts.

5. For a period of years prior to the Company filing for bankruptcy in 2009, QSGI experienced recurring inventory control problems. Throughout the relevant period, Company personnel: (1) shipped certain inventory received into its facilities out to customers without making the appropriate entries into the Company's books and records; and (2) removed items from physical inventory without relieving the inventory from the Company's books and records. Company personnel removed component parts from the physical inventory for such parts without recording the parts removed and occasionally stripped component parts from operating systems without recording the parts removed. As a result, the Company's books and records incorrectly reflected certain components in inventory and operating systems as intact systems. These component parts were then sold by the Company or used for the Company's maintenance services.

6. These internal control problems resulted in the falsification of QSGI's books and records relating to QSGI's inventory.

7. These inventory control problems escalated at the Minnesota facility beginning in 2007 for several reasons. First, a manufacturer's policy of curtailing resellers' ability to modify machines to customers' specifications hastened QSGI's shift from selling machines to selling parts and providing repair and maintenance services. This, in turn, exacerbated the problem in Minnesota of personnel removing component parts from operating systems without any corresponding adjustment to the Company's books and records. The units continued to be recorded on the books and records as intact systems. Second, key personnel, including accounting personnel, left the Minnesota operations in late 2007. Personnel designated to replace the departed accounting staff lacked an accounting background and failed to fully carry out their responsibilities. Third, while QSGI management had undertaken to design, document, and implement internal controls to come into compliance with federal securities law requirements, such efforts were not begun in earnest in Minnesota until late 2007, after the departure of key personnel. Prior to that point, QSGI senior management had accorded Minnesota personnel a fair amount of autonomy, including using an accounting system that differed from the one used in New Jersey.

8. The Company's efforts to introduce new controls to the Minnesota operations during the 2008 fiscal year largely failed. More particularly, the Company failed to design procedures taking into account the existing control environment, including the qualifications and experience level of persons employed to handle accounting. Training of accounting, sales, and warehouse personnel either did not take place or was inadequate. As a result, controls the Company attempted to implement in February 2008 were widely ignored during the ensuing ten months of the 2008 fiscal year and well into the 2009 fiscal year. For example, sales and warehouse personnel often failed to document their removal of items from inventory or, to the extent they did prepare the paperwork, accounting personnel often failed to process the paperwork and to adjust inventory in the company's financial reporting system. The Company's attempts to monitor compliance on an ongoing basis were also inadequate. Company personnel regularly circumvented controls.

9. In periodic filings with the Commission relating to the relevant period and certifications included therein pursuant to Rule 13a-14 of the Exchange Act, Sherman acknowledged his responsibility for the design and operation of internal controls.

10. During the relevant period, Sherman knew of ongoing deficiencies in and the circumvention of internal controls relating to inventory. For example, in the final days of the 2008 fiscal year, QSGI senior management, including Sherman, communicated openly amongst themselves about the failed implementation, including training in, and circumvention of controls introduced to the Minnesota operations earlier in the year. Management agreed that corrective action was needed which, given the timing, could not be undertaken until 2009. Based on further communications, management, including Sherman, was aware that the problems continued through the Company filing for bankruptcy in July 2009.

Sherman's False Representations in Management's Report on ICFR and Concerning QSGI's Critical Accounting Policies

11. At no time during the relevant period did Sherman disclose, or direct anyone else to disclose, to QSGI's external auditors the foregoing inventory issues and the resulting falsification of QSGI's books and records.

12. To the contrary, in management representations letters to the auditors, Sherman made affirmative misrepresentations and made statements that were misleading as a result of his omitting material facts which were necessary in order to make the statements made not misleading. Sherman affirmatively represented in management representation letters he provided to the auditors in connection with their review of quarterly financial statements in 2008 that either there were no significant deficiencies or that he had disclosed to the auditors all such deficiencies. At the conclusion of the fiscal year, he provided yet another management representation letter in connection with the external auditors' audit of the 2008 fiscal year financial statements in which he acknowledged his responsibility for establishing and maintaining ICFR. Omitted from the letter was any reference to the existence, or his disclosure to the auditors, of significant

deficiencies. Following on his management representation letters for the first three quarters of 2008, however, and in the context of his having acknowledged in the year-end management representation letter his responsibility for establishing and maintaining ICFR, the omission of any reference to significant deficiencies implied falsely that none existed. In the management representation letter relating to the external auditors' review of the first quarter 2009 financial statements, Sherman affirmatively misrepresented that he had disclosed to the auditors all significant deficiencies.

13. Had Sherman disclosed to the external auditors the deficiencies in and the circumvention of inventory controls described above, the auditors would have changed the nature, timing, and extent of their procedures in conducting the audit of the financial statements for the fiscal year ended December 31, 2008 and review of the financial statements for the quarter ended March 31, 2009.

Sherman's False Representations in Management's Report on ICFR and Concerning QSGI's Critical Accounting Policies

14. QSGI's Form 10-K for the fiscal year ended December 31, 2008 included a Company management's report on ICFR, as required by Section 404 of the Sarbanes-Oxley Act and Exchange Act Rule 13a-15(c). A management's report on ICFR was also included in a Form 10-K/A for the 2008 fiscal year.

15. The management report included in both filings falsely represented that QSGI's management, with the participation of QSGI's CEO, Sherman, had evaluated QSGI's ICFR as of December 31, 2008 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. In fact, Sherman, in his capacity as CEO, did not participate in the referenced evaluation and was unfamiliar with the referenced framework.

16. The discussion on critical accounting policies in QSGI's Form 10-K for the fiscal year ended December 31, 2008 falsely stated that "[m]anagement continually monitors its inventory valuation . . . ."

17. The discussion on critical accounting policies included in QSGI's Form 10-K/A for the fiscal year ended December 31, 2008 falsely stated that, "[m]anagement closely monitors and analyzes inventory for potential obsolescence and slow-moving items on an item-by-item basis . . . ."

18. Sherman knew, or was reckless in not knowing, that these statements were materially false and misleading because he knew that the Company did not closely monitor inventory in the manner described because the Company lacked the necessary resources.

19. Sherman signed the 2008 Form 10-K in his capacity as Chief Executive Officer and Chairman of QSGI's Board of Directors. Sherman signed the 2008 Form 10-K/A in his capacity as Chairman, CEO, CFO and CAO. He was the sole signing

officer of the Form 10-K/A. The 2008 Form 10-K and Form 10-K/A were filed with the Commission on March 31, 2009 and July 23, 2010, respectively.

Sherman's False Sarbanes-Oxley Certifications

20. Pursuant to Sarbanes-Oxley Act Section 302 and Exchange Act Rule 13a-14, Sherman signed certifications which were attached to QSGI's 2008 Forms 10-K and 10-K/A and Form 10-Q for the periods ended December 31, 2008 and March 31, 2009, respectively.

21. Sherman individually certified in each filing that, based on his and the other certifying officer's "most recent evaluation of [ICFR]," they had disclosed to QSGI's external auditors all significant deficiencies, "in the design or operation of [ICFR] which are reasonably likely to adversely affect [QSGI's] ability to record, process, summarize and report financial information." Omitted from the certification attached to the Form 10-K, but included in the certification attached to the Form 10-Q, were Sherman's certifications to the effect that the other certifying officer and he: (1) had been responsible for establishing and maintaining ICFR and designing, or supervising others in the design of, ICFR; and (2) had designed, or caused to be designed, such ICFR.

22. Sherman's certifications were false because: (1) he had not participated in designing, establishing, or maintaining ICFR, and had not evaluated ICFR; and (2) the other certifying officer and Sherman had not made the referenced disclosures to the external auditors.

23. Sherman knew, or was reckless in not knowing, that his certifications were materially false and misleading.

24. As mentioned, Sherman signed the 2008 Form 10-K and Form 10-K/A, which were filed with the Commission. Sherman also signed the Form 10-Q for the first quarter of 2009 in his capacity as CEO and Chairman of the Board of Directors, which was filed with the Commission on May 14, 2009.

E. VIOLATIONS

25. Exchange Act Section 10(b) and Rule 10b-5 thereunder prohibit, in connection with the purchase or sale of any security: (a) the use of any device, scheme, or artifice to defraud; (b) the making of material misrepresentations or omissions; and (c) any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. A finding of scienter is required to establish a violation. *Aaron v. SEC*, 446 U.S. 680, 697 (1980). The three subdivisions of Rule 10b-5 should be considered mutually supportive, rather than mutually exclusive. *See Cady, Roberts & Co.*, 40 S.E.C. 907, 913 (1961) (noting that "a breach of duty of disclosure may be viewed as a device or scheme, an implied misrepresentation, and an act or practice, violative of all three subdivisions").

26. "For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Janus Capital Group, Inc. v. First Derivatives Traders*, 131 S. Ct. 2296, 2302 (2011).

27. Courts construe the "in connection with" requirement flexibly to effectuate its remedial purposes. *SEC v. Zandford*, 535 U.S. 813, 819 (2002). Any statement that is "reasonably calculated to influence the investing public" satisfies the "in connection with" requirement. *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 861-62 (2d. Cir. 1968). When the fraud alleged involves public dissemination in a document on which an investor would presumably rely, the "in connection with" requirement is generally met by proof of the means of dissemination and the materiality of the misrepresentation. *SEC v. Rana Research*, 8 F.3d 1358, 1362 (9th Cir. 1993).

28. Information is material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)). "It is well-settled that information impugning management's integrity is material to shareholders." *United States v. Hatfield*, 724 F. Supp. 2d 321, 328 (E.D.N.Y. 2010).

29. Scienter is the "mental state embracing the intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter can be established by showing knowing misconduct or severe recklessness, which is defined as "an extreme departure of the standards of ordinary care… which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *SEC v. Carriba Air, Inc.*, 681 F.2d 1318, 1324 (11th Cir. 1982).

30. As discussed above, Sherman made materially false and misleading statements in his certifications attached to the Forms 10-K and 10-K/A for the fiscal year ended December 31, 2008 and the Form 10-Q for the quarter ended March 31, 2009 to the effect that the other certifying officer and he had: (1) evaluated QSGI's ICFR; and (2) disclosed to the external auditors all significant deficiencies which were reasonably likely to adversely affect QSGI's ability to record, process, summarize and report financial information. Further, Sherman signed the 2008 Form 10-K and Form 10-K/A in his capacity as an officer which included a management's report on ICFR which falsely stated that he had participated with management, in assessing ICFR pursuant to a specified framework. Sherman knew, or was reckless in not knowing, that these statements were false. As a result of the foregoing, Sherman violated Section 10(b) of the Exchange Act and Rule 10b-5(a), (b), and (c) thereunder.

31. Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets. Section 13(b)(2)(B) of the Exchange Act

requires reporting issuers to devise and maintain effective internal accounting controls. Section 13(b)(5) of the Exchange Act provides that no person shall knowingly falsify any such book, record, or account or circumvent internal accounting controls. Rule 13b2-1 also prohibits the falsification of any book, record, or account subject to Section 13(b)(2)(A).

32. As discussed above, deficiencies in the design and operation of internal controls, particularly relating to inventory in the Minnesota operations, had persisted at QSGI. During the relevant period, these deficiencies included: (1) certain inventory received into QSGI facilities being shipped out again without being entered into the Company's books and records; (2) items being removed from physical inventory without being relieved from inventory on the books and records; and (3) the failure to disclose significant deficiencies to the external auditors, and the provision of false management representation letters to the external auditors in connection with their audit of the 2008 fiscal year and review of the first quarter 2009 financial statements. The deficiencies were reflective of a failure to design internal controls mindful of the control environment, including the qualifications of personnel tasked with accounting functions, and the circumvention of such controls as existed. As a result, QSGI failed to devise and maintain effective internal controls and to make and keep books, records and accounts that accurately and fairly reflected the transactions and dispositions of the Company's assets. Sherman caused these violations by failing to design effective internal controls; circumventing controls that existed; and withholding information from the external auditors and making false representations or material omissions in management representation letters. As a result of the actions described above, Sherman caused QSGI's violations of Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B), and violated Exchange Act Section 13(b)(5) and Rule 13b2-1 thereunder.

33. Exchange Act Rule 13b2-2 prohibits any director or officer of an issuer from directly or indirectly making or causing to be made a materially false or misleading statement or omitting to state, or causing another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to an accountant in connection with financial statement audits, reviews, or examinations or the preparation or filing of any document or report required to be filed with the Commission.

34. As discussed above, following on his management representation letters for the first three quarters of 2008 and in the context of his having acknowledged in the management representation letter accompanying the Form 10-K for the fiscal year ended December 31, 2008 his responsibility for establishing and maintaining ICFR, his omission of any reference from the latter to significant deficiencies implied falsely that none existed. He affirmatively misrepresented in a management representation letter relating to the external auditors' review of the first quarter 2009 financial statements that he had disclosed all significant deficiencies in internal accounting controls. As a result of the actions described above, Sherman violated Exchange Act Rule 13b2-2.

35. Exchange Act Rule 13a-14(a), which the Commission promulgated in response to Section 302 of the Sarbanes-Oxley Act, requires that the issuer's principal

executive officer and principal financial officer certify each periodic report containing financial statements filed by an issuer pursuant to Section 13(a) of the Exchange Act. The certifications are included as exhibits to the Forms 10-K and 10-Q.

36. Item 601(b)(31) of Regulation S-K prescribes the wording. Amongst other things, it requires the certifying officer to certify that the other certifying officer(s) and he/she, "are responsible for establishing and maintaining . . . . internal control over financial reporting . . . ," and (1) ". . . . [d]esigned such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision . . . . ; and (2) " . . have disclosed, based on [their] most recent evaluation of internal control over financial reporting, to the registrant's auditors . . . [a]ll significant deficiencies . . . in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information . . . ."

37. Sherman falsely certified in the certifications attached to the Forms 10-K and 10-K/A for the fiscal year ended December 31, 2008 and the Form 10-Q for the quarter ended March 31, 2009, respectively, that he had: (1) evaluated QSGI's ICFR; and (2) disclosed all significant deficiencies to the external auditors which were reasonably likely to adversely affect QSGI's ability to record, process, summarize, and report financial information. As a result, Sherman violated Exchange Act Rule 13a-14 by signing false Section 302 certifications.

F. FINDINGS

Based on the foregoing, the Commission finds that Sherman: (a) violated Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14, 13b2-1, and 13b2-2 promulgated thereunder; and (b) caused QSGI's violations of 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

IV.

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

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

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 10(b), 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14, 13b2-1 and 13b2-2 promulgated thereunder.

B. Respondent is prohibited for a period of five (5) years from the date of the 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 shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $7,500 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). 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 Sherman 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 Scott W. Friestad, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

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.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4065 / April 20, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31558 / April 20, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16501

In the Matter of

BLACKROCK ADVISORS, LLC
and
BARTHOLOMEW A. BATTISTA,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTIONS 9(b) and 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against BlackRock Advisors, LLC ("BlackRock"), and pursuant to Section 203(k) of the Advisers Act and Section 9(f) of the Investment Company Act against Bartholomew A. Battista ("Battista") (together "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. This matter concerns investment adviser BlackRock's failure to disclose a conflict of interest involving the outside business activity of one of its portfolio managers. Daniel J. Rice, III was a well-known, long-standing top-performing energy sector portfolio manager. Rice joined BlackRock in 2005 and managed BlackRock energy-focused registered funds, private funds, and separate accounts. In 2007, Rice founded Rice Energy, L.P. – a Rice family-owned-and-operated oil and natural gas production company. Rice was the general partner of Rice Energy and personally invested approximately $50 million in the company. Rice's three sons were the CEO, CFO, and VP of Geology of Rice Energy. In February 2010, Rice Energy formed a joint venture with Alpha Natural Resources, Inc. ("ANR"), a publicly-traded coal company held in the BlackRock funds and accounts managed by Rice. By June 30, 2011, ANR stock was the largest holding (9.4%) in the Rice-managed $1.7 billion BlackRock Energy & Resources Portfolio, primarily as a result of ANR acquiring two other public companies held in that portfolio. BlackRock knew of Rice's involvement with and investment in Rice Energy as well as the joint venture with ANR, but failed to disclose Rice's conflict of interest to the BlackRock funds' boards of directors or to BlackRock advisory clients.

2. BlackRock also failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder, as required by Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, concerning the outside activities of its employees, including how they should be assessed and monitored for conflict purposes, and when an employee's outside activity should be disclosed to the BlackRock funds' board of directors or to BlackRock advisory clients. BlackRock's chief compliance officer ("CCO"), Bartholomew A. Battista, caused BlackRock's compliance-related violations.

3. BlackRock and Battista also caused the registered funds' failure to have the funds' chief compliance officer report to the funds' boards of directors – in violation of Rule 38a-1(a)(4)(iii)(B) under the Investment Company Act of 1940 – Rice's violations of BlackRock's private investment policy. BlackRock and Battista knew about Rice's violations, and knew or should have known that they were not reported to the funds' boards.

Respondents

4. **BlackRock Advisors, LLC**, a Delaware limited liability company headquartered in Wilmington, Delaware, is an investment adviser registered with the Commission. According to its Form ADV filed in June 2014, BlackRock has assets under management of approximately $452 billion. BlackRock is a subsidiary of BlackRock, Inc., an investment management firm with assets under management of approximately $4.3 trillion as of December 31, 2013.

5. **Bartholomew A. Battista,** age 56 and a resident of Sicklerville, New Jersey, was the CCO of BlackRock during the relevant period. Battista joined BlackRock in 1998.

Other Relevant Individual and Entities

6. **Daniel J. Rice III** was a managing director at BlackRock and a co-portfolio manager of approximately $4.5 billion in energy sector assets held in BlackRock registered and private funds as well as separately managed accounts. Rice joined BlackRock in January 2005 and separated from the firm in December 2012.

7. **Rice Energy, LP ("Rice Energy")** was a Delaware limited partnership headquartered in Canonsburg, PA. Rice Energy was founded by Rice in February 2007. During the relevant period, Rice Energy was a Rice family-owned-and-operated oil and gas exploration and production company that focused on drilling oil and natural gas wells. In January 2014, Rice Energy, Inc., a Rice Energy affiliate, completed its $1 billion initial public offering of 50 million shares of common stock, at a price of $21 per share (NYSE: RICE).

Facts

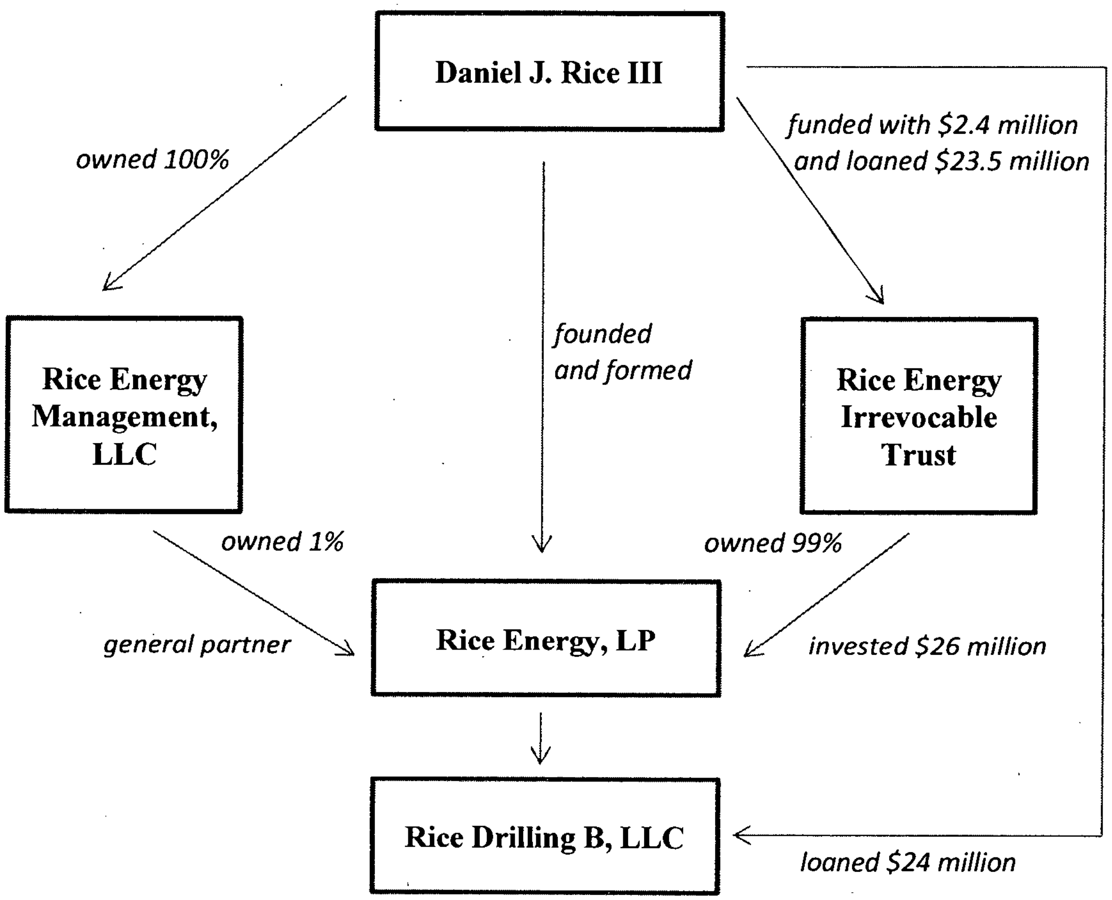
A. Rice's Outside Business Activity Created a Conflict of Interest at BlackRock

8. In late 2004, BlackRock recruited Rice to join BlackRock. Rice joined BlackRock in January 2005 as a managing director and co-portfolio manager of energy sector assets held in BlackRock registered funds, private funds, and separately managed accounts. As an incentive to join the company, BlackRock agreed to pay Rice a portion of the annual investment advisory fees earned on the Rice-managed funds and separate accounts – as a result, Rice was one of BlackRock's most highly compensated portfolio managers.

9. In December 2006 and while employed at BlackRock, Rice formed and funded the Rice Energy Irrevocable Trust (the "Rice Energy Trust") to hold interests in "Rice Energy," which referred to energy companies that Rice intended to create in the future and be managed by his adult children. Rice funded the trust with approximately $2.4 million in gifts as well as $23.5 million in term loans.

10. In February 2007 and while employed at BlackRock, Rice formed Rice Energy, Rice Energy Management, LLC ("REM"), and a Rice Energy drilling subsidiary. In February 2008, Rice formed another Rice Energy drilling subsidiary, Rice Drilling B, LLC ("Rice Drilling B"). Rice was the 100% owner of REM, which was the sole general partner of Rice Energy. Due to his ownership interest, Rice had the ability to exercise broad power and authority over Rice Energy. Through REM, Rice was not only the general partner of Rice Energy, but he also owned 1% of Rice Energy, and the remaining 99% was owned by the Rice Energy Trust.

11. Between 2007 and mid-2010, Rice had invested in and loaned to Rice Energy a total of approximately $50 million.



12. Rice's three sons, who were Rice Energy's Chief Executive Officer, Chief Financial Officer, and Vice President of Geology, routinely shared information regarding Rice Energy operational issues with Rice, and sought and received direction and advice from Rice. Rice also was a manager at two Rice Energy drilling subsidiaries, including Rice Drilling B. Rice and his sons exercised their power and authority to manage the business and affairs of the companies and made decisions on their behalf.

13. Rice used his BlackRock email address for Rice Energy related communications during which Rice discussed the company. For example, Rice used his industry connections to solicit business partnerships through which Rice Energy would gain access to land on which to drill.

14. During Rice's tenure as a BlackRock portfolio manager, Rice Energy solicited a joint venture with Foundation Coal, a public company held in the Rice-managed funds and separate accounts. In mid-2008, Rice Energy started exploring a potential joint venture, and by early 2009 substantive discussions between the two companies had begun, but final plans were placed on hold until after the merger of Foundation Coal and ANR was completed in July 2009. Shortly after the merger, Rice formed a third Rice Energy drilling subsidiary to hold Rice Energy's interest in its anticipated joint venture with ANR. In October 2009, Rice – in his role as general partner and on behalf of Rice Energy – signed a letter of intent to form the joint venture with ANR. In February 2010, Rice Energy finalized the joint venture with ANR.

15. By the end of the first quarter of 2010 and after the formation of the joint venture with ANR, the Rice-managed funds and separate accounts together held over two million shares of ANR stock, with the largest fund – the $1.2 billion BlackRock Energy & Resources Portfolio – maintaining a 3.5% position in ANR, making it one of the fund's top ten largest holdings. By the end of the second quarter of 2011 and after ANR acquired Massey Energy, a second public company already held in the Rice-managed funds and separate accounts, the number of shares held in ANR stock increased to over eight million, with the largest fund – the $1.7 billion BlackRock Energy & Resources Portfolio – maintaining a 9.4% position in ANR, making it the fund's largest holding.

B. BlackRock Approved Rice's Outside Business Activity

16. By no later than January 2007, BlackRock learned that Rice had formed and funded the Rice Energy Trust in violation of BlackRock's private investment policy. By at least that time, certain BlackRock senior executives, including Battista, were told that Rice intended to form and fund Rice Energy. BlackRock's Legal and Compliance Department, including Battista, reviewed and discussed the matter and allowed Rice to form Rice Energy. BlackRock concluded that it did not see any conflict of interest with regard to Rice Energy. By no later than January 2010, BlackRock learned that Rice had made additional loans of approximately $14 million to a Rice Energy subsidiary in violation of BlackRock's private investment policy.

17. BlackRock did not report the formation or funding of the Rice Energy Trust or Rice Energy to the boards of directors of the Rice-managed registered funds or to advisory clients. BlackRock also did not advise the funds' boards of Rice's violations of BlackRock's private investment policy. BlackRock did not monitor or reassess Rice's outside business activity and the conflicts associated therewith between January 2007 and January 2010.

18. In January 2010, Rice told BlackRock that he wanted to serve on the board of directors of the joint venture between Rice Energy and ANR. At that time, BlackRock's Legal and Compliance Department did not recall its review of Rice Energy in early 2007. Incorrectly believing this was the first time it was learning about Rice Energy, BlackRock's Legal and Compliance Department conducted several fact-gathering discussions with Rice that resulted in a February 2010 memorandum addressed to Rice ("February 2010 memorandum").

19. Because the Rice-managed funds and separate accounts held ANR stock, the February 2010 memorandum stated the following with respect to conflicts:

> There are potential conflicts of interest in entering joint ventures with companies that you hold in your BlackRock client portfolios and funds. By participating in a personal joint venture with an issuer that you invest in on behalf of your clients, you may create the appearance of a conflict, with respect to whose interests are being placed first (yours or the client's). Additionally, by investing with a company that you hold in your portfolios you raise the concern that you may have access to ANR specific information which you could use for your benefit instead of for your client's.

20. Despite BlackRock's acknowledgement of potential conflicts of interest and the concern that Rice may have access to ANR-specific information that Rice could use for his personal benefit to the detriment of his clients, BlackRock allowed Rice to continue his involvement with and financial investment in Rice Energy while continuing to serve as a BlackRock portfolio manager. As stated in the February 2010 memorandum, to which Rice agreed, BlackRock further allowed Rice to continue managing the ANR stock positions held in the Rice-managed funds and separate accounts, provided that he: (i) not participate in any decisions with respect to the joint venture; (ii) not become a board member of the joint venture; (iii) not receive material information about the joint venture that could restrict Rice's ability to trade in ANR; and (iv) pre-clear with BlackRock any future Rice Energy-related board seats intended to be taken by Rice. BlackRock did not provide any disclosure about Rice Energy or the February 2010 memorandum to the funds' boards or to advisory clients.

21. BlackRock did not follow-up with Rice about Rice Energy thereafter. Instead, BlackRock expected Rice to report back to BlackRock. BlackRock did not monitor or initiate any reassessment of Rice's involvement with Rice Energy. BlackRock did not verify whether certain steps specified in its February 2010 memorandum were taken by Rice, such as removing references to BlackRock from the Rice Energy website – and, ultimately, those references were not removed until after the June 2012 press articles about Rice's involvement with Rice Energy raised questions about the related conflicts of interest.

22. From time to time, Rice discussed other Rice Energy matters with certain BlackRock senior executives. For example, in May 2010 BlackRock approved Rice's sale of certain of his personal securities holdings so that he could make a $10 million loan to Rice Energy. In another instance, in May 2011 Rice received approval from a senior executive in BlackRock's Legal and Compliance Department to participate in a private placement debt offering by Rice Drilling B. The Rice Drilling B private placement memo (the "PPM") described Rice's role at Rice Energy – namely, as founder and managing general partner, as well as co-manager with his son of Rice Drilling B – and his role as managing director and portfolio manager at BlackRock. Rice also made the opening remarks on the offering's internet video roadshow used to solicit potential investors and stated his affiliation with Rice Energy and BlackRock, although at the direction of the BlackRock senior executive, Rice also noted that BlackRock did not have an equity interest or an implied interest in Rice Energy. In December 2011, Rice also notified certain BlackRock senior executives that, in connection with an investment by a private equity family of funds in Rice Energy, Rice's prior loans to a Rice Energy subsidiary would be converted to a direct equity interest in a newly formed Rice Energy subsidiary.

C. BlackRock Breached Its Fiduciary Duty by Failing to Disclose the Conflict of Interest

23. BlackRock did not inform the boards of directors of the Rice-managed registered funds or advisory clients about Rice's involvement with and investment in Rice Energy. Although senior executives in BlackRock's Legal and Compliance Department considered the disclosure issue in privileged communications, no disclosure was made. On June 1, 2012, The Wall Street Journal published the first of three articles detailing Rice's connection to Rice Energy, and his simultaneous role as an energy sector portfolio manager at BlackRock.

24. As an investment adviser, BlackRock has a fiduciary duty to exercise the utmost good faith in dealing with its clients – including to fully and fairly disclose all material facts and to employ reasonable care to avoid misleading its clients. It is the client, not the investment adviser, who is entitled to determine whether a conflict of interest might cause a portfolio manager – consciously or unconsciously – to render advice that is not disinterested.

25. BlackRock breached its fiduciary duty by failing to disclose to the funds' boards and advisory clients the conflict of interest created when BlackRock permitted Rice to form, invest, and participate in an energy company while Rice was also managing several billion dollars in energy sector assets held in BlackRock funds and separate accounts. The conflict of interest became more acute once Rice Energy finalized its joint venture with ANR, as the Rice-managed funds and separate accounts held significant positions in ANR stock.

D. BlackRock Failed to Adopt and Implement Policies and Procedures Regarding Outside Activities

26. BlackRock did not have any written policies and procedures regarding the outside activities of its employees. BlackRock only required pre-approval for an employee to serve on a board of directors and had a general conflicts of interest provision in its Code of Business Conduct

and Ethics ("Code") that addressed conflicts or potential conflicts that could arise from the personal activities or interests of BlackRock employees. Pursuant to the Code, BlackRock required all conflicts and potential conflicts to be reported to a supervisor, manager, or a member of BlackRock's Legal and Compliance Department.

27. BlackRock failed, however, to adopt and implement policies and procedures that addressed how the outside activities of BlackRock employees were to be assessed for conflicts purposes, as well as who was responsible for deciding whether the outside activity should be permitted.

28. BlackRock also failed to adopt and implement policies and procedures to monitor those employees with BlackRock-approved outside activities, so that BlackRock would stay informed about any changes in the employee's outside activity and re-evaluate it, if necessary.

29. As BlackRock's CCO, Battista was responsible for the design and implementation of BlackRock's written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. Battista knew and approved of numerous outside activities engaged in by BlackRock employees (including Rice), but did not recommend written policies and procedures to assess and monitor those outside activities and to disclose conflicts of interest to the funds' boards and to advisory clients. As such, Battista caused BlackRock's failure to adopt and implement these policies and procedures.

30. In January 2013, BlackRock subsequently adopted new written policies and procedures addressing the outside activities of BlackRock employees.

E. Respondents Caused the Funds' Failure to Report Rice's Policy Violations to the Funds' Boards of Directors

31. BlackRock had a private investment policy that, among other things, required employees to receive BlackRock's approval before making any private investments.

32. Rice violated BlackRock's private investment policy by not obtaining pre-approval to: (i) form and fund the Rice Energy Trust; and (ii) make approximately $14 million in loans to a Rice Energy subsidiary.

33. BlackRock and Battista knew about Rice's violations of its private investment policy, and also knew or should have known that these violations were "material compliance matters" under Rule 38a-1 and, hence, were required to be reported to the boards of directors of the Rice-managed registered funds. BlackRock and Battista also knew or should have known that the funds did not, in fact, report Rice's violations to the funds' boards.

Violations

34. As a result of the conduct described above, BlackRock willfully[1] violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon a client or prospective client.[2] BlackRock breached its fiduciary duty by failing to disclose a conflict of interest – namely Rice's involvement with and investment in Rice Energy – to the BlackRock funds' boards of directors or to advisory clients.

35. As a result of the conduct described above, BlackRock willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. BlackRock failed to adopt and implement written policies and procedures to assess and monitor the outside activities of its employees and to disclose conflicts of interest to the funds' boards and to advisory clients. Battista caused BlackRock's compliance-related violations.

36. As a result of the conduct described above, BlackRock and Battista caused certain BlackRock funds' violations of Rule 38a-1(a) under the Investment Company Act. Rule 38a-1(a)(4)(iii)(B) requires registered investment companies, through their chief compliance officer, to provide a written report at least annually to the fund's board of directors that addresses each material compliance matter that occurred since the date of the last report. Rule 38a-1, in pertinent part, defines a "material compliance matter" as any compliance matter about which the fund's board of directors would reasonably need to know to oversee fund compliance, and that involves, without limitation, a violation of the policies and procedures of its investment adviser. BlackRock and Battista caused the failures by certain BlackRock funds to report all material compliance matters – namely Rice's violations of BlackRock's private investment policy – to their boards of directors.

Undertakings

BlackRock undertakes to complete the following actions:

37. Independent Compliance Consultant. BlackRock shall retain, within thirty (30) days of the issuance of this Order, an Independent Compliance Consultant ("Consultant") not unacceptable to the staff of the Commission, and provide a copy of this Order to the Consultant. The Consultant's compensation and expenses shall be borne exclusively by BlackRock. BlackRock shall require the Consultant to conduct a comprehensive review of BlackRock's written compliance policies and procedures regarding the outside activities of BlackRock

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[1] 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)).

[2] A violation of Section 206(2) of the Advisors Act does not require scienter, but, rather, may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau*, Inc., 375 U.S. 180, 195 (1963)).

employees and any conflicts of interest derived therefrom to ensure that they comply with Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and Rule 38a-1 under the Investment Company Act, as appropriate.

a. BlackRock shall provide to the Commission staff, within thirty (30) days of retaining the Consultant, a copy of an engagement letter detailing the Consultant's responsibilities, which shall include the review described above in paragraph 37.

b. At the end of the review, which in no event shall be more than one hundred twenty (120) days after the date of the entry of this Order, BlackRock shall require the Consultant to submit a Report to BlackRock and the staff of the Commission ("Report"). The Report shall address the issues described above in paragraph 37, and shall include a description of the review performed, the conclusions reached, the Consultant's recommendations for changes in or improvements to BlackRock's policies and procedures, and a procedure for implementing the recommended changes in or improvements to those policies and procedures.

c. BlackRock shall adopt all recommendations contained in the Report within ninety (90) days of receipt; provided, however, that within thirty (30) days of BlackRock's receipt of the Report, BlackRock shall, in writing, advise the Consultant and the Commission staff of any recommendations that it considers unnecessary, unduly burdensome, impractical, or inappropriate. With respect to any such recommendation, BlackRock need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. As to any recommendation on which BlackRock and the Consultant do not agree, such parties shall attempt in good faith to reach an agreement within thirty (30) days after BlackRock provides the written notice described above. In the event that BlackRock and the Consultant are unable to agree on an alternative proposal, BlackRock and the Consultant shall jointly confer with the Commission staff to resolve the matter. In the event that, after conferring with the Commission staff, BlackRock and the Consultant are unable to agree on an alternative proposal, BlackRock will abide by the recommendations of the Consultant.

d. Within thirty (30) days of BlackRock's adoption of all of the recommendations in the Consultant's Report, as determined pursuant to the procedures set forth herein, BlackRock shall certify in writing to the Consultant and the Commission staff that it has adopted and implemented all of the Consultant's recommendations in the Report. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to Jeffrey B. Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5010, or such other address as the Commission's staff may provide.

e. BlackRock shall cooperate fully with the Consultant and shall provide the Consultant with access to files, books, records, and personnel as are reasonably requested by the Consultant for review.

f. To ensure the independence of the Consultant, BlackRock (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's staff; (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; and (iii) shall not invoke the attorney-client or any other doctrine or privilege to prevent the Consultant from communicating with or transmitting any information, reports, or documents to the Commission's staff.

g. BlackRock shall require the Consultant to enter into an agreement providing that for the period of the engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing, or other professional relationship with BlackRock, 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 BlackRock, 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.

38. Recordkeeping. BlackRock shall preserve for a period of not less than six (6) years from December 31, 2014, the first two (2) years in an easily accessible place, any record of its compliance with the undertakings set forth in this Order.

39. Notice. BlackRock shall promptly revise its Form ADV to disclose the existence of the Order in accordance with such Form and its instructions, and deliver the amended Form ADV to its clients to the extent required by and in accordance with the requirements of the Advisers Act and the rules thereunder.

40. Deadlines. For good cause shown, the Commission staff may extend any of the procedural dates relating to the undertakings. Deadlines for 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.

41. Certification of Compliance. BlackRock shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance with the undertakings 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 BlackRock agrees to provide such evidence.

The certification and supporting material shall be submitted to Jeffrey B. Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5010, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than thirty (30) days from the date of the completion of the undertaking.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act with respect to BlackRock, and pursuant to Section 203(k) of the Advisers Act and Section 9(f) of the Investment Company Act with respect to Battista, it is hereby ORDERED that:

A. Respondent BlackRock cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder, and Rule 38a-1 under the Investment Company Act.

B. Respondent Battista 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)-7 promulgated thereunder, and Rule 38a-1 under the Investment Company Act.

C. Respondent BlackRock is censured.

D. Respondent BlackRock shall, within thirty (30) calendar days of the entry of this Order, pay a civil money penalty in the amount of $12 million to the Securities and Exchange Commission. Respondent Battista shall, within thirty (30) calendar days of the entry of this Order, pay a civil money penalty in the amount of $60,000 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) 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 the relevant entity or individual as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

E. Respondent BlackRock shall comply with the undertakings enumerated in Section III above.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31560 / April 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16503

In the Matter of **KORNITZER CAPITAL MANAGEMENT, INC. AND BARRY E. KOSTER,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Kornitzer Capital Management, Inc. ("KCM") and Barry E. Koster ("Koster") (collectively, "Respondents").

II.

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

III.

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

Summary

1. This proceeding relates to certain inaccurate and incomplete information furnished by a registered investment adviser, Kornitzer Capital Management, Inc., and its chief financial officer and chief compliance officer, Barry E. Koster, in connection with the process under Section 15(c) of the Investment Company Act by which KCM obtained the renewal of its advisory contracts with ten separate series of the Buffalo Funds (collectively, the "Funds"), all of which share a common board of trustees (the "Board").

2. Each year from 2010 through 2013 (the "Relevant Period"), the Board requested an analysis of KCM's profitability in managing the Funds, including an explanation of KCM's methodology for allocating its expenses, for purposes of this analysis, among the Funds and its other clients. Such information was reasonably necessary for the Board's evaluation of KCM's advisory contracts with the Funds. Koster, acting on behalf of KCM, prepared and provided to the Board the requested analysis and explanation of KCM's expense allocation methodology, which specifically represented that KCM allocated all employee compensation expenses to the Funds "based on estimated labor hours." In fact, in each year, Koster adjusted the allocation of the compensation of KCM's chief executive officer to the Funds in a manner designed, in part, to achieve consistency of KCM's reported profitability in managing the Funds year over year. Koster did not disclose this information to the Board. As a result, KCM failed to furnish information that was reasonably necessary for the Board to evaluate the terms of KCM's advisory contracts in violation of Section 15(c) of the Investment Company Act, and Koster caused KCM's violations.

Respondents

3. KCM, a Kansas corporation headquartered in Shawnee Mission, Kansas, has been registered as an investment adviser with the Commission since 1989. KCM has been the investment adviser to the Funds since their launch. It also acts as the adviser to separately managed private and institutional accounts and seventeen trust funds of an unregistered trust company. According to its most recently filed Form ADV, Part 2A, KCM manages accounts with combined assets under management of approximately $11.3 billion.

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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.

4. Barry E. Koster, age 54 and a resident of Leawood, Kansas, has been the chief financial officer of KCM since 2002. In 2004, Koster became the chief compliance officer ("CCO") of KCM and the Funds but relinquished his CCO role with both KCM and the Funds in April 2015.

Other Relevant Parties

5. The Buffalo Funds, a Delaware statutory trust with its principal place of business in Shawnee Mission, Kansas, has been registered with the Commission as an open-end investment company since 1994. Throughout the Relevant Period, the Buffalo Funds operated as a series trust with ten different series.

6. KCM's chief executive officer ("the CEO") is the majority owner of KCM and has been its president and CEO since he founded the company in 1989. During the relevant period, the CEO also served as KCM's chief investment officer and the co-portfolio manager to one of the Funds.

Section 15(c) of the Investment Company Act and the Related Fund Filing Reports and Disclosures

7. Section 15(c) of the Investment Company Act makes it unlawful for a registered fund to enter into or renew any advisory contract unless the terms of the contract are approved by a majority of the fund's independent directors. As part of the approval process, Section 15(c) imposes a duty on all directors to request and evaluate, and a duty on an adviser to furnish, such information as may reasonably be necessary for the directors to evaluate the terms of the adviser's contract.

8. While Section 15(c) does not define what is "reasonably necessary" to evaluate a contract's terms, the Commission has promulgated various fund filing disclosure requirements to better inform shareholders about a board's evaluation process when approving or renewing an advisory contract. Specifically, in 2004, the Commission adopted form amendments, which replaced the previous statement of additional information requirements and required that when a fund board approves or renews any advisory contract, the fund's next shareholder report must discuss, in reasonable detail, the material factors and conclusions with respect thereto that formed the basis for the directors' approval or renewal of that contract. See Disclosure Regarding the Approval of Investment Advisory Contracts by Directors of Investment Companies, Investment Company Act Release No. 26486 (June 30, 2004).

9. As to the approval or renewal of an advisory contract, funds must include a discussion in their shareholder reports concerning, among other things, the costs of the services to be provided and profits to be realized by the investment adviser and its affiliates from the relationship with the fund. See Form N-1A, Item 27(d)(6)(i). As noted by the Commission, "[i]t would be difficult for a board to reach a final conclusion as to whether to approve an advisory contract without reaching conclusions as to each material factor." Investment Company Act Release No. 26486 (Emphasis added).

Facts

The Board's Section 15(c) Request Regarding KCM's Profitability for Managing the Funds

10. During the Relevant Period, the Board considered the renewal of KCM's advisory contracts with each Fund at the Board's November board meeting. In advance of each of those board meetings, the Board requested certain information from KCM for the Board's consideration of KCM's advisory contracts, including an "[a]nalysis of the profitability of each Fund to the Adviser over the past two years, including expenses related to services provided to each Fund, with an explanation of the expense allocation methodology." KCM's profitability analysis was reasonably necessary for the Board's consideration of KCM's advisory contracts under Section 15(c) of the Investment Company Act.

11. Indeed, as described in the Buffalo Funds' shareholder reports during the Relevant Period, the Board considered KCM's costs of services to be provided and profits to be realized from its management of the Funds in determining whether to renew KCM's advisory contracts. For example, the Buffalo Funds' March 31, 2012 Annual Report disclosed, in relevant part, that "[t]he Trustees also examined the level of profits that could be expected to accrue to the Adviser from the fees payable under the Agreements...[and] concluded that the Adviser's profit from sponsoring the Funds had not been and would not be excessive and would enable the Adviser to maintain adequate profit levels to support its provision of advisory services to the Funds."

KCM's Profitability Analyses and Disclosures of Its Expense Allocation Methodology

12. During the Relevant Period and in response to the Board's requests, KCM provided the Board with a one-page analysis of its profitability in managing the Funds for its latest two fiscal years.[2] KCM's profitability analysis included line items for, among other things: total revenue; total operating expenses; net operating income before income taxes; and net income before income taxes.

13. KCM's only revenue from the Funds was the investment advisory fees it earned from managing the Funds, which required no estimation. However, because KCM also served as the investment adviser to other clients, only a portion of its total operating expenses were attributable to services provided to the Funds for purposes of analyzing KCM's profitability with respect to the Fund's advisory contracts. Therefore, and per the

[2] Each year during the Relevant Period, KCM prepared its financial statements using fiscal years ending on March 31. Throughout the Relevant Period, KCM's profitability analysis used its financial results for its two most recent fiscal years ended March 31 for the Board's consideration of advisory contract renewal in November of that year. For example, for the Board's consideration of advisory contract renewal in November 2012, KCM provided profitability analysis for its fiscal year ended March 31, 2011 and March 31, 2012.

Board's request, KCM's profitability analysis also included an explanation of its methodologies for allocating various expenses, for purposes of this analysis, to the Funds.

14. With respect to KCM's allocation of employee compensation, for 2010, 2011, and 2012, KCM represented as follows: "salaries and benefits – allocated based on estimated labor hours." KCM's profitability analysis for 2013 repeated that disclosure, but also specified that KCM allocated the CEO's compensation based on a "percentage (estimate) of time working on the Buffalo Funds and intangible value to the Buffalo Funds based on leadership, decision making and management responsibilities."

Adjustment of the Allocation of the CEO's Compensation Expenses to KCM's Management of the Funds

15. During the Relevant Period, Koster was responsible for preparing KCM's profitability analysis and the explanation of its expense allocation methodology. Koster was also responsible for determining how much of each KCM employee's total compensation to allocate to the Funds.

16. Employee compensation constituted KCM's largest expense allocated to its management of the Funds during the Relevant Period. For example, in fiscal year 2013, employee compensation made up approximately 87% of KCM's total operating expenses. During the Relevant Period, the compensation expense of the CEO made up a significant portion of KCM's reported operating expenses in managing the Funds.

17. Contrary to what KCM had stated in its profitability analyses furnished to the Board, each year during the Relevant Period, Koster did not allocate the CEO's compensation to the Funds based solely upon the CEO's estimated labor hours, but also took into account other factors. Specifically, each year, Koster:

a. Reviewed KCM's total revenue, total operating expenses, and reported profitability from the prior fiscal year;

b. Considered KCM's revenue growth in the latest fiscal year;

c. Considered what profit margin would result from the proposed allocation of the CEO's compensation; and then

d. Allocated a percentage of the CEO's compensation to the Funds in a manner in part designed to achieve consistency of KCM's reported profitability in managing the Funds.

18. Among other things, Koster sought to portray that KCM maintained consistent pre-tax net profit margins from year to year. As indicated in paragraph 12, above, KCM's profitability analysis for each year included line items for total revenue and net operating income before income taxes. As described herein, the pre-tax net profit margin is equal to the net operating income before income taxes divided by total revenue.

19. For KCM's fiscal years 2010 through 2012, KCM's total revenue from managing the Funds increased each year from approximately $22.6 million, to $31 million, to $34.1 million, respectively. In those same years, Koster likewise increased the percentage of the CEO's compensation allocated to the Funds from 35%, to 40%, to 49.5%, respectively. By doing so, KCM reported almost identical pre-tax net profit margins year over year as follows:

KCM's Fiscal Year-End	KCM's Total Revenue from Managing the Funds	Percentage of CEO's Compensation Allocated to the Funds	KCM's Reported Pre-Tax Net Profit Margin
2010	$22,654,560	35%	28.1%
2011	$31,017,648	40%	26.9%
2012	$34,138,538	49.5%	26.8%

20. In KCM's fiscal year 2013, its total revenue for managing the Funds increased by more than 11% to approximately $38 million. Also in that fiscal year, the CEO's compensation increased by more than 70% from the prior year. In part, in order to avoid showing a significant reduction in KCM's profitability, Koster allocated just 25% of the CEO's compensation to managing the Funds, which resulted in a reported pre-tax net profit margin of approximately 40%.

21. During the Relevant Period, KCM did not disclose to the Board that Koster considered other factors beyond estimated labor hours in allocating CEO compensation expense or that Koster adjusted the percentage of the CEO's compensation allocated to the Funds in part in order to maintain the consistency of KCM's reported profitability.

22. For each year during the Relevant Period, Koster's adjustment to the allocation of the CEO's compensation to the Funds caused information concerning KCM's reported profitability in managing the Funds to be inaccurate and incomplete.

23. During the Relevant Period, information regarding KCM's profitability, including the metrics described in paragraph 12, above, and KCM's methodology for allocating employee compensation expenses to the Funds, was reasonably necessary for the Board to evaluate the terms and renewal of the advisory contracts between KCM and the Funds. In particular, this information was reasonably necessary for the Board's determination that KCM's profitability in managing the Funds had not been and would not be excessive and would enable KCM to maintain adequate profit levels to support its provision of advisory services to the Funds.

Violations

24. As a result of the conduct described above, KCM violated Section 15(c) of the Investment Company Act, which makes it the duty of an investment adviser to a registered investment company to furnish such information as may reasonably be necessary for the investment company's directors to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser to such company.

25. As a result of the conduct described above, Koster caused KCM's violations of Section 15(c) of the Investment Company Act.

IV.

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

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

A. Respondents KCM and Koster cease and desist from committing or causing any violations and any future violations of Section 15(c) of the Investment Company Act;

B. Respondents KCM and Koster shall, within 10 days of the entry of this Order, pay a civil money penalty in the amounts of $50,000 and $25,000, respectively, to the Securities and Exchange Commission. If timely payments are not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofin.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 Respondent's name as 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, Denver Regional Office, U.S. Securities and Exchange Commission, Byron G. Rogers Federal Building, 1961 Stout Street, Suite 1700, Denver, CO 80294.

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 Koster, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Koster 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 Koster 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74772 / April 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16502

In the Matter of Hi-Q Wason, Inc., IPI Fundraising, Inc., and Luminary Acquisition 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 Hi-Q Wason, Inc., IPI Fundraising, Inc., and Luminary Acquisition Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Hi-Q Wason, Inc. (CIK No. 1086605) is a British Virgin Islands corporation located in Taipei, Taiwan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hi-Q Wason is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 8-A registration statement on July 6, 1999.

2. IPI Fundraising, Inc. (CIK No. 1314689) is a void Delaware corporation located in Newark, Delaware with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IPI Fundraising is delinquent in its periodic

filings with the Commission, having not filed any periodic reports since it filed a Form 8-A registration statement on October 3, 2005.

3. Luminary Acquisition Corp. (a/k/a City Central Acquisition Corp.) (CIK No. 1100380) is a Delaware corporation located in Washington, D.C. with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Luminary is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2007, which reported a net loss of $2,890 from the company's March 24, 1999 inception to December 31, 2007.

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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
April 21, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4067 / April 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15850

In the Matter of MATTHEW D. SAMPLE	ORDER GRANTING PETITION FOR REVIEW AND SCHEDULING FILING OF STATEMENTS

Pursuant to Commission Rule of Practice 431,[1] the petition of Matthew D. Sample for review of the February 4, 2015 order[2] is granted. The February 4, 2015 order was issued by the Division of Enforcement pursuant to delegated authority.

Accordingly, IT IS ORDERED, pursuant to Rule of Practice 431, that Matthew D. Sample may file a statement in support of his petition by May 21, 2015. The Division of Enforcement may file a statement in opposition by June 22, 2015, and Matthew D. Sample may file any statement in reply by July 6, 2015.

It is further ORDERED that the February 4, 2015 order denying Sample's application shall remain in effect.

By the Commission.

Brent J. Fields
Secretary

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

1 17 C.F.R. § 201.431.

2 *Matthew D. Sample*, Investment Advisers Act Release No. 402, 2015 WL 456508 (Feb. 4, 2015).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74779 / April 22, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16505

In the Matter of **First American Scientific Corp., and Immunosyn 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 First American Scientific Corp. and Immunosyn Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. First American Scientific Corp. (CIK No. 1002822) is a defaulted Nevada corporation located in Abbotsford, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). First American Scientific 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 March 31, 2012, which reported a net loss of $249,744 for the prior nine months. As of April 14, 2015, the company's stock (symbol "FASC") 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. Immunosyn Corp. (CIK No. 1375623) is a void Delaware corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Immunosyn 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, 2010, which reported a net loss of $5,375,568 from the company's August 3, 2006 inception to September 30, 2010. As of April 14, 2015, the company's stock (symbol "IMYN") was traded on the over-the-counter market.

B. DELINQUENT PERIODIC FILINGS

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

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

Brent J. Fields
Secretary

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

Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74782 / April 22, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16504

In the Matter of W2007 Grace Acquisition I, Inc., Respondent.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against W2007 Grace Acquisition I, Inc. ("W2007 Grace" 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 Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing 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. These proceedings arise out of violations of the issuer reporting requirements under the federal securities laws and the misapplication of the rules concerning the counting of holders of record promulgated thereunder.

2. Pursuant to Section 15(d) of the Exchange Act and the rules promulgated thereunder, a company that files a registration statement pursuant to the Securities Act of 1933 (the "Securities Act") which becomes effective must file periodic and other reports. Rule 12h-3 of the Exchange Act permits an issuer to suspend its Section 15(d) reporting obligations by filing a certification on Form 15 if the issuer has fewer than 300 holders of record of the class of securities offered under the Securities Act registration statement.[1] But if that issuer has 300 or more holders of record on the first day of any subsequent fiscal year, the suspension ends. Once the suspension ends, the reporting obligation returns without any action by the issuer and the issuer must resume periodic reporting, starting with the filing of an annual report on Form 10-K for its preceding fiscal year within 120 days, pursuant to Rule 12h-3(e) of the Exchange Act.

3. Section 15(d) was promulgated "to assure a stream of current information about an issuer for the benefit of purchasers in the registered offering, and for the public." SEC Rel. No. 34-20263, 1983 SEC LEXIS 2765, at *4-5 (Oct. 5, 1983). But "Congress recognized, with respect to Section 15(d), that the benefits of periodic reporting by an issuer might not always be commensurate with the burdens imposed" and so provided that the duty to file reports under Section 15(d) for any class of securities shall be automatically suspended for any fiscal year where that class of securities had fewer than 300 holders of record on the first day of the fiscal year. SEC Rel. No. 34-20263, 1983 SEC LEXIS 2765, at *5 (Oct. 5, 1983). Section 15(d) further authorizes the Commission to "define by rules and regulations the term 'held of record' as it deems necessary or appropriate in the public interest or for the protection of investors in order to prevent circumvention of the provision of this subsection." 17 U.S.C. § 78o(d)(1). Pursuant to Section 15(d), the Commission promulgated Rule 12g5-1 setting out the definition of the term "held of record" and with it, the methodology for counting holders of record.

4. On October 25, 2007, Equity Inns, Inc. ("Equity Inns") merged with and into W2007 Grace, a newly formed entity indirectly owned by one or more Whitehall Real Estate Funds, real estate private equity funds affiliated with The Goldman Sachs Group, Inc. ("Goldman Sachs") (the "Merger"). Prior to the Merger, Equity Inns was a reporting issuer under the Exchange Act and its 8.75% Series B Cumulative Preferred Stock ("Equity Inns Series B") and 8.00% Series C Cumulative Preferred Stock ("Equity Inns Series C") (collectively, the "Equity Inns

[1] The rule may not be invoked, however, with regard to the year in which the registration statement became effective or was required to be updated under Section 10(a)(3) of the Securities Act.

Preferred Stock") were each listed on the New York Stock Exchange ("NYSE") and registered pursuant to Section 12(b) of the Exchange Act.

5. In connection with the Merger, (a) each share of common stock of Equity Inns outstanding immediately prior to the effective time of the Merger was converted into the right to receive \$23.00, without interest; (b) each share of Equity Inns Series B and Equity Inns Series C outstanding immediately prior to the effective time of the Merger was converted into the right to receive one share of W2007 Grace 8.75% Series B Cumulative Preferred Stock ("Series B") and W2007 Grace 8.00% Series C Cumulative Preferred Stock ("Series C") (collectively, the "Preferred Stock"), respectively. Pursuant to Rule 15d-5 of the Exchange Act, W2007 Grace succeeded to Equity Inns' Section 15(d) Exchange Act reporting obligations with respect to the Preferred Stock.

6. On November 6, 2007, Equity Inns filed with the Commission a notice of suspension of duty to file reports pursuant to Section 15(d) of the Exchange Act on Form 15 certifying that its Preferred Stock had 66 and 36 holders of record, respectively.[2] On the first day of each fiscal year thereafter through 2013, there continued to be less than 300 holders of record of the Preferred Stock, not taking into account certain trusts created in 2012.[3]

7. As set forth below, W2007 Grace undercounted its holders of record as of January 1, 2014, and thus, on January 1, 2014, had 300 or more holders of record of the Preferred Stock. W2007 Grace, as successor registrant, therefore was required to file an annual report on Form 10-K for 2013 within 120 days and seven periodic and other reports afterwards, including reports on Form 10-Q and Form 8-K. W2007 Grace did not make these filings as required by Section 15(d) and Rules 15d-1, 15d-11, and 15d-13 thereunder.

Respondent

8. W2007 Grace is a Tennessee corporation with its principal place of business in Texas. W2007 Grace, a real estate investment firm, indirectly owned by one or more Whitehall Real Estate Funds, real estate private equity funds affiliated with Goldman Sachs, acquired Equity Inns through the Merger. Prior to the Merger, Equity Inns was a reporting issuer with both common stock and preferred stock listed on the NYSE. In connection with the Merger, all of the stock was deregistered with the Commission and delisted from the NYSE. The Common Stock converted into the right to receive cash merger consideration as part of the transaction, and the preferred stock of Equity Inns was converted into the Preferred Stock. On November 6, 2007, W2007 Grace filed with the Commission a notice of suspension of duty to file reports pursuant to Section 15(d) of the Exchange Act on Form 15.

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[2] W2007 Grace has treated the Series B and Series C as having "substantially similar character and the holders of which enjoy substantially similar rights and privileges" and thus as a single "class" for purposes of Section 15(d). 15 U.S.C. §78o(d)(1).

[3] In late 2012, a single shareholder, Joseph M. Sullivan, transferred some of his Preferred Shares to 300 separate trusts, each designated as a "JMS Trust" and each with Mr. Sullivan as the designated trustee (the "JMS Trusts").

Applicable Legal Framework

9. Section 15(d) requires any issuer which has filed a registration statement pursuant to the Securities Act to file periodic and other reports. Pursuant to Rule 12h-3(a) of the Exchange Act, such reporting obligation "shall be suspended for such class of securities immediately upon filing with the Commission a certification on Form 15" certifying that the issuer has fewer than 300 holders of record of a class of securities. 17 CFR § 240.12h-3(a). Securities are treated as a single class where they have "substantially similar character and the holders of which enjoy substantially similar rights and privileges." 15 USC § 78l(g)(5).

10. As prescribed by Section 15(d), the Commission promulgated Rule 12g5-1 to define the term "held of record" "for the protection of investors in order to prevent circumvention of" Section 15(d). When adopting Rule 12g5-1, the Commission explicitly determined not to equate "held of record" with the beneficial holder of the security.[4] Instead, the Commission wrote Rule 12g5-1 so as to "simplify[] the process by which customers determine whether or not they are covered by the new provisions."[5]

11. Under Rule 12g5-1's process for counting holders of record, securities are "deemed to be 'held of record' by each person who is identified as the owner of such securities on records of security holders maintained by or on behalf of the issuer," with certain exceptions contained in the rule. SEC Staff Report on Authority to Enforce Exchange Act Rule 12g5-1 and Subsection (b)(3), 2012 WL 814601, at *4 (Oct. 15, 2012). The rule allows certain entries on the issuer's list of security holders – in this case, the transfer agent list – to be aggregated. Specifically, paragraph (a)(6) of Rule 12g5-1 permits the issuer to aggregate "[s]ecurities registered in substantially similar names where the issuer has reason to believe because of the address or other indications that such names represent the same person."

12. By definition, every company is a separate "person." 17 USC § 78c(a)(9). Paragraph (a)(2) of Rule 12g5-1 requires that "Securities identified as held of record by a corporation, a partnership, a trust whether or not the trustees are named, or other organization shall be included as so held by one person." Thus, each trust and/or corporation listed as a registered holder is a separate holder of record.

13. Further, paragraph (a)(3) of Rule 12g5-1 requires that "Securities identified as held of record by one or more persons as trustees, executors, guardians, custodians or in other fiduciary capacities with respect to a single trust, estate or account shall be included as held of record by one person." Neither paragraph (a)(3) nor paragraph (a)(6) permit shares "held of record" by a person in an individual capacity and also separately, for one or more accounts, in a

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[4] Securities Exchange Act Release No. 34-7492 (Jan. 14, 1965) ("The Commission has determined not to adopt at this time the provision that securities registered in the name of a broker, dealer, or bank, or nominee for any of them, and held in customers' accounts, shall be counted as held of record by the number of separate accounts for which the securities are held").

[5] Id.

custodial capacity, to be aggregated as a single holder of record, even though the same person would make investment decisions regarding all of the shares.

W2007 Grace's Misapplication of the Counting Rules

14. On November 6, 2007, Equity Inns filed with the Commission a notice of suspension of duty to file reports pursuant to Section 15(d) of the Exchange Act on Form 15 certifying that its Preferred Stock had 66 and 36 holders of record, respectively. On the first day of each fiscal year thereafter through 2013, Equity Inns continued to have fewer than 300 holders of record, not taking into account the JMS Trusts.

15. As of January 1, 2014, however, and since that date, W2007 Grace has continuously had 300 or more holders of record, not taking into account the JMS Trusts. Specifically, Respondents, incorrectly aggregated as one holder of record three separate custodial accounts. Respondents also incorrectly aggregated three corporate entities under the theory that these entities were controlled by the same entity. But because each corporation and each separate custodial account are separate holders of record, these aggregations were a misapplication of Rule 12g5-1(a)(6). As a result, W2007 Grace undercounted its holders of record at January 1, 2014 and violated Section 15(d) by not resuming its Exchange Act reporting as required by Rule 12h-3(e).

16. Thus, W2007 Grace, as successor registrant, was required to file an annual report on Form 10-K for 2013 within 120 days and seven periodic and other reports afterwards, including reports on Form 10-Q and Form 8-K. W2007 Grace did not make these filings as required by Section 15(d) and Rules 15d-1, 15d-11, and 15d-13 thereunder.

Respondent's Remedial Efforts

17. In determining to accept the Offer, the Commission considered certain remedial acts undertaken by Respondent and cooperation afforded to Commission staff.

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 W2007 Grace's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 15(d) of the Exchange Act and Rules 15d-1, 15d-11, and 15d-13 thereunder.

B. Respondent shall resume periodic reporting pursuant to Section 15(d) of the Exchange Act by filing an annual report on Form 10-K for fiscal year 2014 on or before May 15, 2015, and filing an annual report on Form 10-K for fiscal year 2013 and any periodic reports required to be filed on or before July 1, 2015; and

C. Respondent shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $640,000 to the Securities and Exchange Commission for transfer to the general fund of United States Treasury in accordance with Exchange Act Section 21F(g)(3). 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 W2007 Grace 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 Timothy Casey, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 74781 / April 22, 2015

WHISTLEBLOWER AWARD PROCEEDING

File No. 2015-2

In the Matter of the Claim for Award

in connection with

Redacted

Redacted

Notice of Covered Action Redacted

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

On December 15, 2014, the Claims Review Staff ("CRS") issued a Preliminary Determination related to Notice of Covered Action Redacted (the "Covered Action"). The Preliminary Determination recommended that Claimant ("Claimant") receive a whistleblower award because Claimant 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).[1]

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1 Claimant was a Redacted at the time Claimant obtained the information. As a result, in preliminarily determining that Claimant had provided original information, the CRS considered whether Claimant's information was derived from Claimant's independent knowledge or independent analysis. Under Rule 21F-4(b)(1), "[i]n order for [a] whistleblower submission to be considered original information, it must," among other requirements, be "[d]erived from [the whistleblower's] independent knowledge or independent analysis." 17 C.F.R. § 240.21F-4(b)(1). In turn, Rule 21F-4(b)(4)(iii)(B) provides that, unless an exception applies, "[t]he Commission will not consider information to be derived from [a whistleblower's] independent knowledge or independent analysis" if the whistleblower "obtained the information because" the whistleblower was "[a]n employee whose principal duties involve compliance or internal audit responsibilities . . . ." 17 C.F.R. § 240.21F-4(b)(4)(iii)(B). The CRS preliminarily determined that Rule 21F-

Further, the CRS recommended that such award be set in the amount of Redacted Redacted of the monetary sanctions collected or to be collected in the Covered Action, which will equal between $1,400,000 and $1,600,000. In arriving at this recommendation, the CRS 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's application.[2]

On December 16, 2014, Claimant provided written notice to the Commission of Claimant's decision 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). Accordingly, pursuant to Rule 21F-10(f), 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 Rules 21F-10(f) and (h), 17 C.F.R. § 240.21F-10(f) and (h), and for the reasons set forth in the Preliminary Determination, it is hereby ORDERED that Claimant shall receive Redacted of the monetary sanctions collected in this Covered Action.

By the Commission.

Brent J. Fields
Secretary

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

4(b)(4)(iii)(B) did not apply here to disqualify Claimant's information from treatment as original information pursuant to the exception in Rule 21F-4(b)(4)(v)(A), 17 C.F.R. § 240.21F-4(b)(4)(v)(A), because Claimant "had a reasonable basis to believe that disclosure of the information to the Commission [was] necessary to prevent the relevant entity from engaging in conduct that [was] likely to cause substantial injury to the financial interest or property of the entity or investors."

2 The Preliminary Determination also recommended that an award application from a second claimant in connection with the Covered Action should be denied because the second claimant did not provide information that led to the successful enforcement of the Covered Action within the meaning of Section 21F(b)(1) of the Exchange Act and Rules 21F-3(a)(3) and 21F-4(c) thereunder. The second claimant thereafter failed to submit a timely response contesting the Preliminary Determination. Accordingly, pursuant to Rule 21F-10(f), 17 C.F.R. § 240.21F-10(f), the Preliminary Determination to deny the second claimant's award application became the Final Order of the Commission as to that second claimant.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74792 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16507

In the Matter of **StateTrust Investments, Inc.** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b), 15B(c)(2) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b), 15B(c)(2) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against StateTrust Investments, Inc. ("StateTrust" 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 15(b), 15B(c)(2) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

[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.

Summary

These proceedings involve the sale of non-investment grade or "junk" bonds issued by the Commonwealth of Puerto Rico ("Puerto Rico") by StateTrust, a registered broker-dealer and municipal securities dealer, to a customer in an amount below the minimum denomination of the issue. Rule G-15(f) promulgated by the Municipal Securities Rulemaking Board ("MSRB") prohibits dealers from effecting customer transactions in municipal securities in amounts below the minimum denominations of the issues. Minimum denominations are generally intended to limit sales of municipal securities to retail investors for whom such bonds may not be suitable, but the proscriptions of Rule G-15(f) apply to all transactions with customers regardless of whether the securities are suitable for the customer. In March 2014, StateTrust violated MSRB Rule G-15(f) by executing one sales transaction in the Puerto Rico bonds with a customer in an amount below the \$100,000 minimum denomination of the issue. StateTrust also violated MSRB Rule G-17 by failing to disclose to this customer the fact that the bonds had a \$100,000 minimum denomination, and to explain how this could affect the liquidity of the customer's position.

Respondent

1. StateTrust is a Delaware corporation that maintains principal offices in Miami, Florida. It is a registered broker-dealer pursuant to Section 15(b) of the Exchange Act. It is also a municipal securities dealer and municipal securities broker as defined in Sections 3(a)(30) and 3(a)(31) of the Exchange Act.

MSRB Rule G-15(f) and MSRB Rule G-17: Minimum Denomination Requirements for Bond Sales to Customers

2. Section 15B(b) of the Exchange Act established the MSRB and empowered it to propose and adopt rules for transactions in municipal securities by brokers, dealers, and municipal securities dealers. Section 15B(c)(1) of the Exchange Act prohibits a broker, dealer, or municipal securities dealer from using the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in contravention of any rule of the MSRB. As a municipal securities dealer, Respondent is subject to Section 15B(c)(1) of the Exchange Act and MSRB rules.

3. MSRB Rule G-15(f)(i) prohibits a broker, dealer, or municipal securities dealer from effecting a customer transaction in municipal securities issued after June 1, 2002 in an amount lower than the minimum denomination of the issue except pursuant to two limited exceptions. First, under MSRB Rule G-15(f)(ii), a dealer may purchase municipal securities from a customer in an amount below the minimum denomination of the issue if the dealer determines that the customer's position in the issue is already below the minimum denomination and the customer's entire position in the issue would be liquidated by the transaction. Second, under MSRB Rule G-15(f)(iii), a dealer may sell municipal securities to a customer in an amount below the minimum denomination of the issue if the dealer determines that the position being sold resulted from the liquidation of another customer's entire position in the issue which was below the minimum denomination of the issue. Additionally, a dealer selling under MSRB Rule G-15(f)(iii) must, at or before the completion of the transaction, notify the customer that the amount of the transaction is

below the minimum denomination of the issue and that this may adversely affect the liquidity of the customer's position.

4. Under MSRB Rule G-15(f), brokers, dealers, and municipal securities dealers may not sell municipal securities in amounts below the minimum denomination of an issue to a customer regardless of whether the customer holds or would hold a position in the issue which is equal to or exceeds the minimum denomination of the issue. The rule also prohibits brokers, dealers, and municipal securities dealers from purchasing municipal securities in amounts below the minimum denomination of an issue from a customer whose position in the securities equals or exceeds the minimum denomination of the issue unless the customer's position is being liquidated in its entirety.

5. The purpose of MSRB Rule G-15(f) is to ensure municipal securities dealers observe the minimum denominations stated in the official documents of municipal securities issues.[2] Official documents for municipal securities issues may state a "minimum denomination" larger than the normal $5,000 par due to issuers' concerns that the securities may not be appropriate for those retail investors who would be likely to purchase securities in relatively small amounts.[3]

6. MSRB Rule G-17 provides that, "[i]n the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." During the time period of StateTrust's conduct, "[t]he MSRB [had] interpreted this rule to mean, among other things, that dealers are required to disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security."[4] The MSRB has further stated: "[A]ny time a dealer is selling to a customer a quantity of municipal securities below the minimum denomination for the issue, the dealer should consider this to be a material fact about the transaction. The MSRB believes that a dealer's failure to disclose such a material fact to the customer, and to explain how this could affect

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[2] Order Granting Approval of Proposed Rule Change Relating to Minimum Denominations, Exchange Act Release No. 45338, 67 Fed. Reg. 6960 (Feb. 14, 2002); Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Minimum Denominations, Exchange Act Release No. 45174, 66 Fed. Reg. 67342 (Dec. 28, 2001).

[3] Id.

[4] Id. See also MSRB Rule G-47, Supplementary Material §.03(effective July 5, 2014) (providing examples of "information that may be material in specific instances and require time of trade disclosures to a customer," including "fact that a sale of a quantity of municipal securities is below the minimum denomination authorized by the bond documents and the potential adverse effect on liquidity of a customer position below the minimum denomination." Although MSRB Rule G-47 was not in effect at the time of Respondent's conduct, it has since consolidated and codified prior interpretive guidance regarding MSRB Rule G-17 on this subject. See Order Granting Approval of a Proposed Rule Change Consisting of Proposed MSRB Rule G-47, on Time of Trade Disclosure Obligations, Proposed Revisions to MSRB Rule G-19, on Suitability of Recommendations and Transactions, Proposed MSRB Rules D-15 and G-48, on Sophisticated Municipal Market Professionals , and the Proposed Deletion of Interpretive Guidance, Exchange Act Release No. 71665 (Mar. 7, 2014).

the liquidity of the customer's position, generally would constitute a violation of the dealer's duty under rule G-17 to disclose all material facts about the transaction to the customer."[5]

The Puerto Rico General Obligation Bonds of 2014

7. On March 11, 2014, Puerto Rico issued $3.5 billion in General Obligation Bonds of 2014, Series A (CUSIP 74514LE86) (the "2014 Bonds").

8. The 2014 Bonds are non-investment grade securities and are considered "junk" bonds. In March 2014, the 2014 Bonds had a credit rating of "Ba2" by Moody's Investors Service, "BB+" by Standard & Poor's Rating Services, and "BB" by Fitch Ratings.

9. Non-investment grade bonds present substantial risks to retail investors. Risks of investing in non-investment grade bonds include liquidity risk (*i.e.,* risk that an investor will not be able to sell a bond quickly and at an efficient price), credit risk (*i.e.,* risk of loss due to an actual or perceived deterioration in the financial health of the issuer) and interest rate risk (*i.e.*, risk that rising interest rates may cause bond prices to decline). In addition, the market for non-investment grade bonds is constricted by the fact that many municipal bond mutual funds are prohibited by their prospectuses from purchasing non-investment grade bonds.

10. The Official Statement of the Commonwealth of Puerto Rico (the "Official Statement") disseminated in connection with the issue of the 2014 Bonds specifies in pertinent part that the 2014 Bonds "are issuable as registered bonds without coupons in denominations of $100,000 and any multiple of $5,000 in excess thereof." During the relevant period, MSRB Rule G-15(f) permitted dealers to effect customer transactions in the 2014 Bonds in amounts equal to the $100,000 minimum denomination of the issue or amounts greater than $100,000 in increments of $5,000. Dealers could therefore have effected customer transactions for $105,000, $110,000, and so forth. Dealers were prohibited from effecting transactions with customers in the 2014 Bonds in amounts below $100,000, regardless of a customer's aggregate position in the 2014 Bonds.[6]

Sale of 2014 Bonds to a Customer
Below the $100,000 Minimum Denomination of the Issue

11. In March 2014, Respondent executed one unsolicited sales transaction in the 2014 Bonds with a customer in an amount below the $100,000 minimum denomination of the issue established by the issuer, Puerto Rico, and specified in the Official Statement. The limited exceptions provided under MSRB Rule G-15(f) for customer transactions in municipal securities below the

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[5] Notice of Interpretation of Rule G-17 Concerning Minimum Denominations (Jan. 30, 2002), archived at http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2002/2002-05.aspx?n=1#_ftn3. As noted above, this interpretive guidance was subsequently codified by MSRB Rule G-47.

[6] For example, a dealer could not have effected a customer transaction for $100,000, followed by a separate below-minimum-denomination transaction for $5,000, for a total of $105,000. The second transaction would have violated MSRB Rule G-15(f). See Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Minimum Denominations, Exchange Act Release No. 45174, 66 Fed. Reg. 67342 at n.12 (Dec. 28, 2001).

minimum denomination of an issue did not apply to this transaction. StateTrust also failed to disclose to this customer, before or at the time of the trade, that the bonds were issued with a $100,000 minimum denomination, and to explain how this could affect the liquidity of the customer's position.

Violations

12. As a result of the conduct described above, Respondent willfully[7] violated MSRB Rule G-15(f) and MSRB Rule G-17.

13. As a result of Respondent's willful violations of MSRB Rule G-15(f) and MSRB Rule G-17, Respondent willfully violated Section 15B(c)(1) of the Exchange Act.

Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent. After it became aware that it had effected a customer transaction in the 2014 Bonds below the minimum denomination of the issue, Respondent cancelled the transaction prior to settlement. Following the transaction, Respondent conducted additional training regarding compliance with MSRB Rule G-15(f) and MSRB Rule G-17.

IV.

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

Accordingly, pursuant to Sections 15(b), 15B(c)(2) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 15B(c)(1) of the Exchange Act and MSRB Rules G-15(f), G-17 and G-47.

B. Respondent is censured.

C. Respondent shall undertake to review the adequacy of its existing policies and procedures relating to compliance with MSRB Rules G-15(f), G-17 and G-47. After that review, Respondent shall make such changes as are necessary to ensure compliance with MSRB Rules G-15(f), G-17 and G-47, including adopting new policies and procedures or supplementing existing policies and procedures. Respondent shall implement these policies and procedures, and conduct training as to the policies and procedures and compliance with MSRB Rules G-15(f), G-17 and G-47. Respondent shall inform the Commission staff no later than six (6) months after the entry of

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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)).

this Order that it has complied with the above undertakings and shall provide the Commission staff with a copy of its existing policies and procedures as to MSRB Rules G-15(f), G-17 and G-47 at that time.

D. Respondent shall, within seven (7) days of the entry of this Order, pay a civil money penalty in the amount of $90,000 to the Securities and Exchange Commission, of which $45,000 shall be transferred to the Municipal Securities Rulemaking Board in accordance with Section 15B(c)(9)(A) of the Exchange Act, and of which the remaining $45,000 shall be transferred to the general fund of the United States Treasury in accordance with Section 21F(g)(3) of the Exchange Act. 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 StateTrust 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 LeeAnn G. 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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74789 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16506

In the Matter of **Visa Industries of Arizona, Inc.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

In anticipation of the institution of these proceedings, VIIS 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, VIIS consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

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

1. VIIS (CIK No. 355223) is a delinquent Arizona corporation located in Phoenix, Arizona with a class of securities registered with the Commission under Exchange Act Section 12. As of December 5, 2014, the common stock of VIIS (symbol VIIS) was quoted on OTC Link (formerly "Pink Sheets") operated by

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

2. VIIS has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended December 31, 1999.

IV.

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

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

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of VIIS's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9756 / April 23, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74800 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16000

In the Matter of HOUSTON AMERICAN ENERGY CORP., JOHN F. TERWILLIGER, UNDISCOVERED EQUITIES INC., and KEVIN T. McKNIGHT Respondents.	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO HOUSTON AMERICAN ENERGY CORP. AND JOHN F. TERWILLIGER**

I.

On August 4, 2014, the Securities and Exchange Commission ("Commission") instituted cease-and-desist proceedings 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 Houston American Energy Corp. ("Houston American") and John F. Terwilliger ("Terwilliger," and collectively with Houston American, "Respondents").

II.

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, and except as provided herein in Section IV.H, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

RESPONDENTS

1. Houston American is a Delaware corporation headquartered in Houston, Texas. It was incorporated in 2001, and its common stock is registered pursuant to Section 12(b) of the Exchange Act. Between July 2007 and July 2010, its common stock was listed on the Nasdaq Capital Market under the ticker symbol "HUSA." It is currently listed on the NYSE MKT.

2. Terwilliger resides in Houston, Texas. Terwilliger has been Houston American's President and Chief Executive Officer since the company was formed in 2001. At all relevant times, Terwilliger was Houston American's largest individual shareholder, and his shares were pledged as collateral on a margin trading account.

OTHER RELEVANT ENTITIES

3. The entity described herein as the "Investment Bank" is a full-service investment bank and registered broker-dealer with a principal place of business in New Orleans, Louisiana. The Investment Bank acted as the placement agent for Houston American's December 2009 registered offering.

4. The individual identified herein as the "Independent Research Analyst" is an independent equity research analyst who owns and operates an entity that publishes, markets, and distributes the Independent Research Analyst's research reports.

5. The entity described herein as the "Operator" is a division of a South Korean conglomerate based in Seoul, South Korea. During the relevant time period, the Operator had offices in Seoul and in Bogotá, Colombia.

FACTS

Overview of Houston American's Misrepresentations and Omissions Concerning the CPO-4 Block

6. In late 2009, Houston American announced that it had entered a farm-out agreement with the Operator, pursuant to which Houston American obtained a 25% non-

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

operating interest in a 345,452 acre oil and gas exploration and production area in Colombia's Llanos Basin. The exploration and production area is known as the "CPO-4 block."

7. In the months that followed, Houston American, Terwilliger, and their agents promoted Houston American's interest in the CPO-4 block with a series of fraudulent statements and omissions that materially exaggerated the block's value to Houston American and downplayed any associated risks. Among other things, Houston American and Terwilliger, directly and through their agents or other third parties, fraudulently asserted that the block contained "estimated recoverable reserves of 1 to 4 billion barrels" of oil, that the oil was worth between $20 and $25 per barrel "in the ground," and thus that the block was worth more than $3 billion—the equivalent of at least $100 per share—to Houston American.

8. Houston American's reserve estimates lacked any reasonable basis in fact. Terwilliger admitted in sworn testimony that he knew the CPO-4 block had no reserves at all and that the Operator's volume estimates, which conveyed a much greater degree of risk than Houston American's reserve estimates, ranged only from 300 million barrels to approximately one billion barrels. Terwilliger further admitted that, unlike the Operator's volume estimates, which were drawn from extensive regional well data and seismic information for the CPO-4 block, Houston American's multi-billion-barrel reserve estimates were not based on a technical evaluation at all.

9. Terwilliger and Houston American nonetheless based their multi-billion-barrel reserve estimates on, at most, Terwilliger's recklessly wishful thinking. They also failed to disclose, or else baldly mischaracterized, the Operator's volume estimates, and used the fraudulently exaggerated estimates to lay the groundwork for their claims about the block's value.

10. Similarly, Terwilliger and Houston American knew or were reckless in not knowing that the $20 to $25 per barrel valuation, which Terwilliger used to support his claim that the CPO-4 block was worth upwards of $100 per share to Houston American, referred to quantities of oil that were in production from commercially viable wells (*i.e.*, to *reserves*) and not to quantities of oil on speculative plays like the CPO-4 block. Yet Terwilliger and Houston American knowingly or recklessly claimed that the valuation was appropriate for the CPO-4 block.

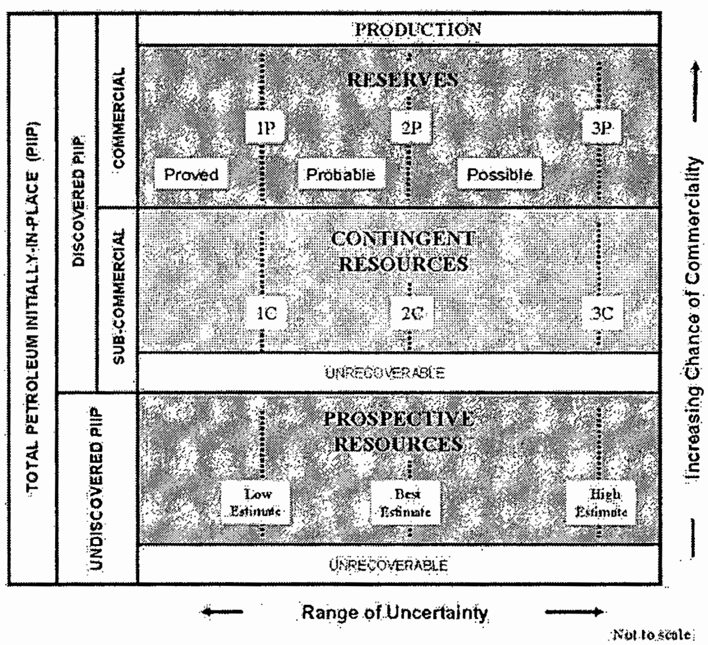
11. Between November 2009 and April 2010, a period during which Houston American and Terwilliger employed multiple fraudulent statements and omissions in connection with their efforts to promote the company's interest in the CPO-4 block, Houston American's stock price increased from approximately $4.00 per share to $20.00 per share, and its market capitalization increased from less than $150 million to more than $600 million.

12. As the truth about the CPO-4 block emerged, Houston American's stock price plummeted. In 2013, Houston American withdrew from its participation in the CPO-4 block after the Operator drilled three dry wells on, and produced no oil from, the block.

13. Houston American now trades for approximately $0.40 per share, which represents a market capitalization loss of $600 million since the April 2010 high.

Common Industry Practices and Terminology

14. In the oil and gas industry, the term "resources" is the principal catch-all term used to describe a quantity of petroleum, whether such quantity is discovered or undiscovered, recoverable or unrecoverable, or conventional or unconventional. The term encompasses four commonly-recognized classes of potentially recoverable petroleum quantities: oil in production, reserves, contingent resources, and prospective resources. The table below, which is taken from the Petroleum Resource Management System ("PRMS"), illustrates the relationship between the various classes of recoverable resources:



15. As shown by the horizontal rows on the PRMS table, the term "prospective resources" describes a quantity of *undiscovered* petroleum, and thus a quantity with the lowest chance of ultimate commerciality (*i.e.*, the class with the highest degree of risk). The term "contingent resources" describes a quantity of discovered but sub-commercial petroleum. The term "reserves" describes an estimated petroleum quantity that has been *discovered* and deemed to be *commercial*, and thus a quantity with the greatest chance of commerciality (*i.e.*, the class with the lowest degree of risk).

16. Ordinarily, a petroleum quantity must meet four criteria in order to qualify as a reserve: it must be discovered, technically recoverable, commercial, and remaining.

17. Reading from left to right, the table uses modifiers to indicate progressively increasing levels of uncertainty that the estimated quantities will actually be recovered. For reserves, the modifiers are "proved," "probable," and "possible"; for prospective resources, they are "low estimate," "best estimate," and "high estimate." Under the rules of the Commission, a "*proved* reserve" is a reserve that "by analysis of geoscience and engineering data, can be estimated *with reasonable certainty* to be economically producible." Both the PRMS guidelines and the Commission rules define "reasonable certainty" as a "high degree of confidence that the quantities will be recovered." A "probable reserve" is "less certain to be recovered than proved reserves" but is "*as likely as not* to be recovered." A "possible reserve" is a reserve quantity that is less certain to be recovered than a probable reserve.

18. While each of the modifiers expresses a different degree of uncertainty, the modifiers do not alter the underlying definition of the relevant class: unlike recoverable resources, all categories of reserves—whether proved, probable, or possible—are quantities that are recoverable from *known accumulations* under existing economic conditions. By contrast, all categories of prospective resources are *undiscovered.*

19. In the oil and gas industry, commonly-used analytical procedures for estimating recoverable quantities of petroleum in exploration-stage projects draw on a wide range of geological and other physical characteristics of the target reservoir and analog wells, including the approximate depth, pressure, temperature, reservoir drive mechanism, original fluid content, reservoir fluid gravity, reservoir size, gross thickness, pay thickness, net-to-gross ratio, lithology, heterogeneity, porosity, permeability, and development plan.

The Operator Evaluates the CPO-4 Block

20. In late 2008, the Operator obtained from the Colombian government exploration and production rights on the CPO-4 block in exchange for a work commitment. The Operator's work commitment required it to shoot and process additional seismic data on the CPO-4 block and to drill multiple exploration wells within a six-year period. The agreement also required the Operator to pay the Colombian government a royalty for any oil that the Operator successfully produced on the CPO-4 block.

21. Before entering the agreement with the Colombian government, the Operator spent several months evaluating the CPO-4 block's oil-bearing potential. As part of that process, the Operator reviewed well log data from the only well that had been drilled on the CPO-4 block and also reviewed well log data from multiple wells drilled on adjacent blocks (the "well log data"). The Operator also analyzed approximately 1,825 kilometers of two-dimensional seismic

data that previously had been shot over the block, and it evaluated comprehensive reports of the known geological formations in the Llanos Basin.

22. The Operator based its evaluation of the CPO-4 block on an analysis of well log and seismic data, which provided important technical information about the block's subsurface structure and its geological characteristics.

23. Well log data, which is collected from an array of tests conducted in a drilled well bore, includes, among other things, data and information about the porosity of potential reservoirs (*i.e.*, the percentage of the total rock or reservoir taken up by "pore" space, and thus the percentage that has the ability to hold a fluid) and the fluid saturation of potential reservoirs (*i.e.*, the percentage of the pore space that holds water, and thus displaces oil). Seismic data allows geoscientists to estimate the size and location of potential oil-bearing reservoirs based on features of the subsurface geology.

24. The Operator used the seismic and well log data, in conjunction with standard analytical procedures for estimating volumes of potentially recoverable petroleum, in its evaluation the CPO-4 block.

25. Based on the geological properties of the CPO-4 block, as discerned in part from its evaluation of well log data, the Operator estimated that it could expect to recover approximately 150 barrels of oil from each "acre foot" (*i.e.*, an area one acre square and one foot deep) of the CPO-4 block's potential accumulations. By analyzing the seismic data, the Operator further estimated that the CPO-4 block had approximately 6.5 million acre feet of potential oil-bearing sands at three different depth horizons.

26. On the basis of those data points, the Operator estimated that the CPO-4 block's potential ranged from 300 million barrels of oil to a "total potential" of 974 million barrels. The Operator further estimated that the block had a "high potential" of approximately 639 million barrels.

27. The Operator did not publicly disclose its estimates for the CPO-4 block, but did share them with Houston American and Terwilliger in late 2009. At no time did the Operator share with Houston American an estimate of more than one billion barrels.

Houston American Farms In to the CPO-4 Block

28. In April 2009, the Operator sought a minority, non-operating farm-in partner on the CPO-4 block in order to offset costs associated with the exploration program for the CPO-4 block. As part of the search, the Operator created a three-page summary document that described the CPO-4 block and depicted the nature and extent of the Operator's evaluation.

Among other things, the summary document stated that the CPO-4 block had "Total 1 Billion [Barrels of Oil] Potential" and "300 [Million Barrels of Oil] Risked Reserve Potential."

29. Houston American and Terwilliger received and reviewed a copy of the summary document in April 2009.

30. Shortly thereafter, Terwilliger met with the Operator's representatives to discuss the potential farm-in opportunity.

31. In addition to the summary document, the Operator compiled a 55-page slide deck that provided information about the basis of the Operator's estimates for the CPO-4 block and about the process it had used to evaluate the block's potential.

32. Among other things, the slide deck depicted the process by which the Operator came to estimate of the block's "total potential" of 974 million barrels and its "high potential" estimate of 639 million barrels.

33. The slide deck included information that was sufficient to show that the Operator's estimates were based on its evaluation of, among other things, block-specific data about the subsurface structure and geological characteristics of potential oil-bearing sands on the CPO-4 block.

34. The slide deck also included information that was sufficient to show that the Operator had arrived at its estimates of the CPO-4 block's "total potential" and "high potential" by using standard analytical procedures for estimating quantities of potentially recoverable oil

35. Terwilliger received and reviewed a copy of the Operator's slide deck.

36. According to Terwilliger's sworn testimony, Houston American and Terwilliger understood that the Operator's estimates were based on "a lot of good work" and that they conformed to "traditional industry practices."

37. Terwilliger and Houston American also understood that the Operator's estimates were based on an extensive evaluation of the regional well log data and seismic data for the CPO-4 block. Terwilliger stated in sworn testimony that "[the Operator] acquired all the available seismic data from the government that they could get . . . . They then reprocessed all the seismic data using . . . their geophysicist, and then they brought together a team of interpreting geoscientists and geologists to interpret the data and identify potential closures within the block."

38. However, Terwilliger admitted that he was not conversant in the technical aspects of the Operator's estimates. When asked in testimony about the key geological inputs that the

Operator had used to derive its volume estimates (*i.e.*, porosity, saturation, formation volume factor, recovery factor), Terwilliger stated that he was "not sure of all these designations" and "I'm not a petroleum engineer, so I'd have to refer to one. . . ."

39. Terwilliger and Houston American did not independently evaluate relevant geological or seismic data for the CPO-4 block or analyze analogous well log data.

40. After reviewing the Operator's slide deck, Houston American submitted a firm offer to acquire a 25% non-operating farm-in interest on the CPO-4 block. The Operator and Houston American entered a farm-in agreement in July 2009, and the Colombian government approved Houston American's participation in October 2009.

Houston American's November 2009 Investor Presentation Uses False and Misleading Statements to Publicize Its Interest in the CPO-4 Block

41. On October 16, 2009, Houston American publicly announced that it had finalized the farm-in agreement with the Operator. The announcement described the CPO-4 block in general terms, but did not include estimates of the block's potential.

42. On October 29, 2009, the Operator delivered to Houston American the 2010 development budget for the CPO-4 block, which included $31 million of expenses heavily concentrated in the first quarter of 2010. Houston American's obligations for the first quarter of 2010 alone were approximately $5 million. At the time, Houston American's public filings showed it to have less than $5 million in cash, and only $5.8 million in total current assets.

43. On November 10, 2009, Houston American publicly released an investor presentation that included 16 slides about the CPO-4 block and the Operator. According to Terwilliger, Houston American created the investor presentation because the "acquisition of the interest in CPO-4 Block . . . was a transitional moment for Houston American. So we took that moment to put a brochure together and go out and try to tell the story."

44. The investor presentation, which was furnished as an exhibit to a Form 8-K that Houston American filed with the Commission, described the CPO-4 block, and, as shown on the slide below, stated that the block "consists of 345,452 net acres and contains over 100 identified leads or prospects with estimated recoverable reserves of 1 to 4 billion barrels."

[redacted] - Farmout Agreement and JOA – CPO 4

- Contract entered between National Hydrocarbon Agency of Colombia and [redacted] a leading Korean conglomerate
- Right to earn an undivided 25% of the rights of the CPO 4 Contract located in the Western Llanos Basin in the Republic of Colombia
- CPO 4 Block consists of 345,452 net acres and contains over 100 identified leads or prospects with estimated recoverable reserves of 1 to 4 billion barrels
- The Block is located along the highly productive western margin of the Llanos Basin and is adjacent to Apiay field which is estimated to have in excess of 610 million barrels of 25-33 API oil recoverable. On the CPO 4 Block's Northeast side lies the Corcel Block where well rates of 2,000 to 14,000 barrels of initial production per day have been announced for recent discoveries.
- In addition, the CPO 4 Block is located nearby oil and gas pipeline infrastructure.
- The Company has agreed to pay 25% of all past and future cost related to the CPO 4 block as well as an additional 12.5% of the seismic acquisition costs incurred during Phase 1 Work Program
- All future cost and revenue sharing (excluding the phase 1 seismic cost) will be on a heads up basis; 75% [redacted] and 25% HUSA - no carried interest or other promoted interest on the block

12 HOUSTON AMERICAN ENERGY CORP

45. Houston American's reserve estimate, as reflected in the November 2009 Investor Presentation, was materially false and misleading in a number of respects.

46. By using the term "reserves," the investor presentation implied that Houston American's multi-billion-barrel estimate was supported by project-specific data and that it referred to discovered, commercially producible petroleum accumulations. However, Houston American's estimate was not in fact supported by such data and analysis, did not refer to discovered, commercially producible petroleum accumulations, and was in fact more than three times larger than the Operator's volume estimates.

47. Despite the clear language of the investor presentation, Terwilliger admitted under oath that "[t]here are no reserves on the CPO-4 block," and that Houston American's widely-disseminated, multi-billion-reserve estimate had "*nothing to do with reserves*." (Emphasis added.)

48. Houston American's investor presentation also implied that the multi-billion-barrel reserve estimate was derived from "100 identified leads or prospects." Because leads or prospects are ordinarily identified through an evaluation of seismic data, the use of "leads and prospects" in the context of Houston American's multi-billion-barrel reserve estimate gave the misleading impression that the estimate was grounded in a technical evaluation of the block.

49. In addition to the false and misleading reserve estimates, the investor presentation also included a number of slides that highlighted the Operator's size and expertise, and the extent of its work in evaluating of the CPO-4 block. Among other things, those slides, which immediately preceded the slide depicted above:

- stated that the Operator was the "undisputed leader" in the petrochemical business in South Korea;
- claimed that the Operator participated in 34 oil and gas blocks and four liquefied natural gas blocks, including 11 blocks in South America;
- depicted some of the wells the Operator had evaluated in its study of the CPO-4 block, including the well previously drilled on the CPO-4 block and approximately 14 others on adjacent blocks;
- summarized the Operator's assessment of seismic and well log data on the block; and
- expressly referred to six months of work that the Operator had spent evaluating data relevant to the CPO-4 block.

50. The investor presentation failed to disclose that Houston American's multi-billion-barrel reserve estimate was much larger than the Operator's volume estimates. By describing the Operator's size, sophistication and expertise, as well as the extent of its evaluation of the CPO-4 block, the investor presentation misleadingly implied that the multi-billion-barrel reserve estimate was backed by the Operator, that it had been drawn from the Operator's analysis of the block, and that it was appropriately characterized as a "reserve."

Houston American And Terwilliger Disseminate False And Misleading Information About The CPO-4 Block Through A Paid Stock Promoter

51. Shortly before releasing the investor presentation, Houston American retained Undiscovered Equities, a marketing firm operated by Kevin McKnight that specialized in small-cap stock promotion. According to Terwilliger, Houston American retained Undiscovered Equities in order to "create more investor awareness using [Undiscovered Equities'] sources."

52. The consulting agreement between Houston American and Undiscovered Equities stated that Undiscovered Equities would assist in "the implementation and maintenance of an ongoing program to increase the investment community's awareness" of Houston American. In exchange, Houston American paid Undiscovered Equities $20,000 per month for at least six months.

53. Beginning in November 2009, Undiscovered Equities posted to its website and distributed to its subscribers a series of promotional articles about Houston American and the CPO-4 block. On November 29, 2009, Undiscovered Equities posted its list of "Top Picks for 2010," which included Houston American. The posting falsely stated that "[*the Operator*] believes the CPO 4 Block has over 100 viable drilling locations with estimated recoverable reserves of 1-4 billion barrels." (Emphasis added.)

54. Terwilliger and Houston American intentionally or recklessly provided McKnight and Undiscovered Equities with the false and misleading statements about the Operator's "belief" concerning the CPO-4 block. They knew or were reckless in not knowing that McKnight and Undiscovered Equities would use the false and misleading statements in connection program to "increase the investment community's awareness" of Houston American.

55. Undiscovered Equities repeated identical claims about the Operator's "belief" in a series of posts over the course of the next three months. Undiscovered Equities also posted anonymous messages to internet message boards for Houston American that directed potential investors back to the articles about Houston American on Undiscovered Equities' website.

56. On its website, Undiscovered Equities and McKnight disclosed that Undiscovered Equities was compensated by Houston American but did not disclose the amount of compensation it received. Neither the promotional articles, in the form distributed to the subscribers, nor the anonymous posts to internet message boards disclosed any information about the fact or amount of compensation that Undiscovered Equities received from Houston American.

Houston American Disseminates False and Misleading Information About the CPO-4 Block During Meetings With Potential Investors

57. In November 2009, Houston American and Terwilliger used the investor presentation in a series of in-person roadshow meetings with institutional investors in Dallas, Detroit, and Chicago. During those meetings, Terwilliger repeated and embellished Houston American's false and misleading claims about the CPO-4 block.

58. At a November 20, 2009 roadshow meeting with a portfolio manager for an institutional investor, Terwilliger said that:

- the CPO-4 block was "Mr. Big for us";
- *the Operator* believed the block had between *three and four billion* barrels of recoverable oil; and

- Houston American believed that the block had between one and five billion barrels.

59. A few days later, Terwilliger met in Dallas with a different institutional investor. During that meeting, Terwilliger said that *the Operator's estimate* for the CPO-4 block was 3.5 billion barrels and that Houston American "used a range" of one to five billion barrels.

60. Terwilliger's statements during the roadshow meetings misrepresented the Operator's actual estimates for the CPO-4 block, and omitted to state that, unlike the Operator's estimates, Houston American's multi-billion-barrel estimate was not based on block-specific data and was not calculated in accordance with standard analytical procedures.

Houston American's Agents Disseminate False And Misleading Information About The CPO-4 Block

61. Houston American raised approximately $13 million in a December 1, 2009 public offering, for which the Investment Bank acted as placement agent.

62. Prior to the offering, Terwilliger met with the Investment Bank's Sales & Trading group and discussed the November 2009 investor presentation. One member of the Sales & Trading group, Sales Representative 1, recalled attending the presentation and hearing the "eye-popping" reserve estimates.

63. After the meeting, and in connection with the public offering, the Investment Bank's Sales & Trading group sent dozens of its institutional clients e-mail messages based on Terwilliger's and Houston American's false and misleading claims about the CPO-4 block.

64. On the morning of the offering, two members of the Sales & Trading group sent e-mail messages about Houston American to more than fifty of the bank's clients. In one such message, a sales representative for the Investment Bank, Sales Representative 2, stated:

> The key is the CPO 4 property that they are partnering on with [the Operator] (largest player in Korea and one of largest in all Asia). The CEO truly believes the potential of the property is 3-5 billion barrels of oil but if we assume it's 1 billion barrels here is some quick math: . . . $4.725bil and with 24mil shares out for HUSA we get $195/share value. This seems ridiculous since the stock is under $5 but that's the math.

65. Sales Representative 1 also sent an e-mail to his clients and to the entire Sales & Trading group under the subject line "HUSA-some crazy math." The e-mail stated:

> I will go through the most sexy property first. . . . [the Operator] has estimated potential of 3-5 Billion barrels of oil under [the CPO-4 block]. . . . I would like to lay out what this would mean to HUSA: Let's say there are only 1 Billion barrels of oil in the ground:
> The Colombian government gets 30% off the top (country standard)
> Leaves 700MM barrels of oil, x .25 (HUSA WI)=175MM barrels of oil
> 175MM barrels x $27 (this was the price for Cara-Cara, based at $85 price deck=$4.725B to HUSA
> $4.725B/24MM shares out=~$200/share to HUSA.

66. The Investment Bank sold 490,000 shares in the offering to investors who received Sales Representative 1's e-mail message.

67. Together, the e-mail messages of Sales Representative 1 and Sales Representative 2 incorporated and repeated at least four fraudulent misrepresentations and omissions made by Houston American and Terwilliger:

- *the Operator*, not Houston American, was the source of the multi-billion-barrel estimate ("[The Operator] has estimated potential of 3-5 Billion barrels of oil");
- one billion-barrels was a conservative estimate, rather than the high end of the Operator's range ("if we assume it's 1 billion barrels" and "Let's say there are only 1 Billion barrels of oil in the ground");
- the putative reserves were worth more than $20 per barrel in the ground;
- the CPO-4 block was worth in excess of $100 per share to Houston American's investors.

68. In the days after the offering, several members of the Investment Bank's Sales & Trading team reiterated similar statements about the CPO-4 block in a series of communications with potential investors.

69. Houston American and Terwilliger knew or were reckless in not knowing that members of the Sales & Trading group would repeat the false and misleading statements and omissions about the CPO-4 block in communications with potential investors.

Houston American Disseminates False and Misleading Statements Through An Independent Research Analyst

70. On February 15, 2010, the Independent Research Analyst published a report on Houston American that repeated the company's the multi-billion-barrel estimate and that assigned a price target of $168 per share to Houston American's common stock. In a section entitled "CPO-4: 'Mind-Boggling,'" the research report stated that the CPO-4 block was worth between $67 and $269 per share to Houston American.

71. The valuation in the Independent Research Analyst's report was premised on two assumptions: that the CPO-4 block held between one and four billion barrels of oil and that the oil was worth between $20 and $25 per barrel in the ground. The report expressly attributed the latter assumption to Houston American: "HUSA believes CPO 4 oil in the ground is worth $20/25/bbl."

72. The content of the research report is directly attributable to Houston American and Terwilliger. In the days before the report was published, Terwilliger spoke with the Independent Research Analyst by phone and stated that:

- the CPO-4 block contained between one and four billion barrels of oil;
- the Operator believed the CPO-4 block contained "up to 3.5 billion barrels" of "recoverable" oil; and
- oil on the CPO-4 block was worth between $20 and $25 per barrel in the ground and had a value of at least $3 billion, or $100 per share, to Houston American.

73. Consequently, the report's valuation of the CPO-4 block was based on false and misleading statements that Terwilliger made to the Independent Research Analyst. Terwilliger and Houston American knew or were reckless in not knowing that the Independent Research Analyst would repeat the false and misleading statements and omissions about the CPO-4 block in subsequent communications with potential investors.

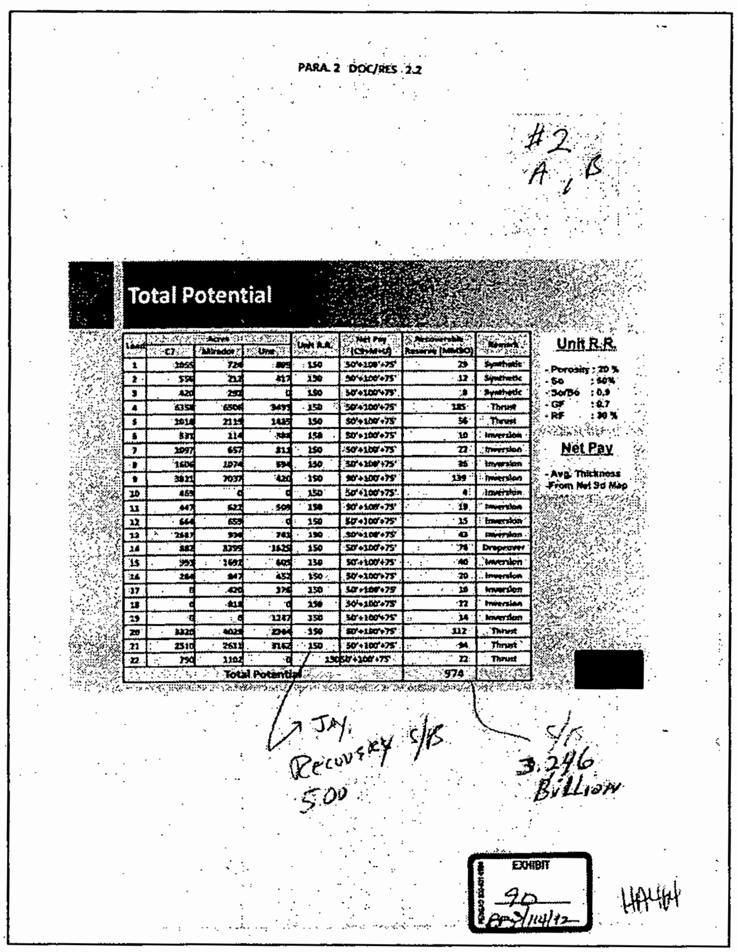
74. The Independent Research Analyst distributed the report to certain of his clients. In addition, a member of Houston American's board of directors, who is an Executive Vice President of a financial services firm based in New York, disseminated the report to the sales force at the financial services firm. One investor reported back to him that the report had become the subject of "cocktail party chatter."

75. The next day, on February 16, 2010, an article published by Dow Jones Newswires noted a spike in Houston American's stock price.

Houston American's and Terwilliger's Multi-Billion-Barrel Estimates Were Not Reasonably Based In Fact

76. Terwilliger and Houston American knowingly or recklessly tripled the Operator's estimates for the CPO-4 block and knowingly or recklessly assigned a valuation of between $20 and $25 per barrel for oil in the ground.

77. The document below is a page from the Operator's slide deck. The version of the page below contains Terwilliger's handwritten notes, which he made in November 2009. The notes reflect Terwilliger's contemporaneous assertion that the Operator's "recovery" *should be* ("S/B") 500 barrels per acre foot rather than 150, and thus that the estimate of recoverable oil *should be* ("S/B") 3.246 billion barrels.



PARA. 2 DOC/RES 2.2

#2
A, B

Total Potential

Lead	Acres C7	Acres Mirador	Acres Une	Unit R.R.	Net Pay (C7+M+U)	Recoverable Reserve (MMBO)	Remark
1	1055	724	895	150	50'+100'+75'	29	Synthetic
2	550	212	417	150	50'+100'+75'	12	Synthetic
3	420	292	0	150	50'+100'+75'	8	Synthetic
4	6358	6506	3495	150	50'+100'+75'	185	Thrust
5	2014	2119	1425	150	50'+100'+75'	56	Thrust
6	337	114	[illegible]	150	50'+100'+75'	10	Inversion
7	1097	657	813	150	50'+100'+75'	22	Inversion
8	1606	1074	894	150	50'+100'+75'	36	Inversion
9	3821	7037	420	150	50'+100'+75'	139	Inversion
10	465	0	0	150	50'+100'+75'	4	Inversion
11	447	622	509	150	50'+100'+75'	19	Inversion
12	664	659	0	150	50'+100'+75'	15	Inversion
13	2687	936	741	150	50'+100'+75'	43	Inversion
14	882	3795	1625	150	50'+100'+75'	78	Drapeover
15	993	1697	605	150	50'+100'+75'	40	Inversion
16	284	847	452	150	50'+100'+75'	20	Inversion
17	0	420	376	150	50'+100'+75'	16	Inversion
18	0	818	0	150	50'+100'+75'	12	Inversion
19	0	0	1287	150	50'+100'+75'	14	Inversion
20	3320	4025	2304	150	50'+100'+75'	112	Thrust
21	2510	2611	3162	150	50'+100'+75'	94	Thrust
22	790	1102	0	150	50'+100'+75'	22	Thrust
Total Potential						974	

Unit R.R.

- Porosity : 20 %
- So : 60%
- So/Bo : 0.9
- GF : 0.7
- RF : 30 %

Net Pay

- Avg. Thickness
- From Net 3d Map

[redacted]

JAY,
RECOVERY S/B
500

S/B
3.246
BILLION

EXHIBIT
90
BP 3/14/12

HA464

78. At no time did Terwilliger and Houston American disclose that they had arrived at their multi-billion-barrel reserve estimate by doing nothing more than tripling the Operator's estimates.

79. Nor did Terwilliger and Houston American disclose that their multi-billion-barrel reserve estimate was based on Terwilliger's beliefs about what the estimates "should be," rather than on an analysis of the geological data pertinent to the CPO-4 block.

80. As alleged above, Terwilliger knew that the Operator's estimates were based on its extensive evaluation of the CPO-4 block and that its evaluation of the block conformed to standard industry practices. Moreover, Houston American and Terwilliger had not independently evaluated the well log or seismic data.

81. During the Division's investigation, Terwilliger sought to defend his and Houston American's decision to more than triple the Operator's estimates, testifying under oath that:

- "[I]n the Llanos Basin, throughout the entire basin, we use 500 barrels per acre-foot recovery. Everyone else does."
- "[the Operator] just stuck 150 barrels. They just applied some very conservative worldwide assumptions;"
- "150 barrels per acre-foot is not recoveries for Colombia, so [the Operator's] report is really a three billion barrel estimate;" and
- "I'm only saying that in ten years in Colombia being involved in over 130 wells and looking at assets all over the basin, I've never seen 150 barrels per acre-foot. Even in the worst wells . . . 300 is probably . . . the lowest I can ever remember seeing. So I discounted [the Operator's] assumptions and said, you know, I'm not going to go through all the engineering models to get there. It's just very unrealistic."

82. However, based on his review of the Operator's slide deck in 2009, Terwilliger knew or was reckless in not knowing that the Operator's estimate was based on its extensive evaluation of the CPO-4 block, and therefore was not drawn from "some very conservative worldwide assumptions" and was not "really a three billion barrel estimate."

83. Terwilliger also knew or was reckless in not knowing that a recovery rate of 150 barrels per acre foot ("BAF") was consistent with rates seen in other parts of the Llanos Basin, and thus could not be disregarded on the grounds that 150 BAF was "not recoveries for Colombia."

84. Terwilliger likewise knew or was reckless in not knowing that Houston American and "everyone else" did not "use 500 barrels per acre-foot" throughout the Llanos Basin.

85. In 2009, Houston American had an interest in a total of 32 wells or potential wells on five different exploration and production concessions in the Llanos Basin, including concessions known the Las Garzas, La Cuerva, and Leona. Of the 32 prospects, 11 were estimated by oil and gas reserve engineers retained by Houston American's business partners to have recoveries of between 100 and 200 BAF. Thirteen others were estimated to have recoveries of between 200 and 300 BAF, and only three were estimated to have recoveries of more than 400 BAF.

86. Accordingly, Terwilliger knew or was reckless in not knowing that the Operator's estimate of 150 BAF was consistent with the rates of recovery for Llanos Basin wells in which Houston American owned an interest in 2009.

87. When presented with evidence about estimated recoveries from those wells, Terwilliger admitted under oath that, of the five exploration and production concessions in Colombia in which Houston American held an interest in 2009 other than the CPO-4 block, he simply did not pay attention to two, and one was a disappointment.

88. Terwilliger testified that:

- "I didn't really pay attention" to Houston American's interest in the 103,000 acre Las Garzas concession, where resource engineers retained by Houston American's partner estimated recovery rates to be as low as 177 BAF;
- "I really wasn't paying attention to" Houston American's interest in the 47,950 acre La Cuerva concession, where resource engineers retained by Houston American's partner estimated recovery rates to be as low as 183 BAF; and
- "We had high hopes for the [70,343 acre] Leona Block. It didn't work out. And as a result, we got a well with recoveries a little over 200 barrels per acre foot. We would have liked 500. . . . " Resource engineers retained by Houston American's partner estimated recovery rates on the Leona Block to be as low as 117 BAF.

89. Accordingly, Houston American's and Terwilliger's decision to triple the Operator's estimates to conform to his "hopes," rather than to data and information about the CPO-4 block itself, intentionally or recklessly distorted the nature and extent of the Operator's evaluation and of Houston American's actual experience in the Llanos Basin.

Houston American's and Terwilliger's Assertions That the Putative Reserves Were Worth Between $20 and $25 Per Barrel "In the Ground" Were Not Reasonably Based In Fact

90. Terwilliger's assertion that the putative reserves on the CPO-4 block were worth between $20 and $25 "in the ground"—which assertion was reflected in Terwilliger's own statements as well as in the statements of Houston American's agents and other third parties—lacked a reasonable basis in fact. Terwilliger admitted as much during the Division's investigation, when he testified under oath that such a valuation was "totally incorrect" because it described a valuation for proved reserves, and there were no proved reserves on the CPO-4 block.

91. Terwilliger and Houston American, as well as their agents, paired misleading statements about the value of the oil "in the ground" with misleading statements about the reserves on the CPO-4 block in support of their misleading claim that the CPO-4 block was worth more than $100 per share to Houston American.

92. An oil and gas reserve engineer retained by Houston American in connection with the Division's investigation made a similar admission in a report submitted to the Commission staff, which stated that "possible reserves were valued at averages ranging from $0.65 to $2.23 per barrel."

Subsequent History

93. In the course of Houston American's promotional efforts, the price of its common stock increased from close to $4 per share to more than $20 per share. In April 2010, two blog posts raised questions about the integrity of Houston American's management and the validity of its estimates. Houston American's stock price promptly fell to $14 per share and, over the next two weeks, it reached a low of approximately $9.00 per share.

94. Since 2010, the Operator and Houston American drilled three non-productive wells on the CPO-4 block, and Houston American's share price has since fallen to approximately $0.40 per share.

95. On March 28, 2013, Houston American announced that it was withdrawing from its farm-in agreement and transferring its interest in the CPO-4 block back to the Operator. In exchange, the Operator released Houston American from past and future funding obligations for the CPO-4 block. Houston American's press statement quoted Terwilliger as stating that "[w]hile the [CPO-4 block] offered exciting potential for Houston American, the complexity and cost of drilling the prospects and the disappointing test wells clearly pointed our company in a different direction."

96. Over the life of the project, Houston American raised and spent more than $20 million to fund its share of expenses on the CPO-4 block without producing a single barrel of oil.

97. Between 2010 and 2012, Terwilliger received cash bonuses of $914,287, stock awards of $247,800, and options valued at $177,049, in addition to a total salary of $1,043,083.

98. During the relevant period, Terwilliger's shares were pledged as collateral on a margin account maintained at Morgan Stanley Smith Barney. In April 2012, Terwilliger sold 985,519 shares for $1,816,509, at an average price of $1.84 per share in order to cover margin calls on the account.

VIOLATIONS

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

100. 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.

101. As a result of the conduct described above, Terwilliger and Houston American acted through or by means of other persons to make material misstatements and omissions, and as a result, violated Section 20(b) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

102. As a result of the conduct described above, Terwilliger caused Houston American's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

IV.

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

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

A. Respondents cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, and 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 promulgated 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.

B. Respondent Terwilliger is prohibited for a period of five (5) years from the date of this Order from serving or 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 Terwilliger shall, within ten (10) business days of the entry of this Order, pay a civil money penalty in the amount of $150,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.

D. Respondent Houston American shall, within ten (10) business days of the entry of this Order, pay a civil money penalty in the amount of $400,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.

E. Payment must be made in one of the following ways:

(1) Respondents may make direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(2) 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

F. Payments by check or money order must be accompanied by a cover letter identifying the payee as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-6010.

G. The Commission will hold funds paid in this proceeding in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, in accordance with Exchange Act Section 21F(g)(3), transfer them to the general fund of 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 ("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 a Fair Fund is created, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

H. 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 Terwilliger, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Terwilliger 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 Terwilliger 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9757 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16000

In the Matter of HOUSTON AMERICAN ENERGY CORP., JOHN F. TERWILLIGER, UNDISCOVERED EQUITIES, INC., AND KEVIN T. McKNIGHT Respondents.	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AS TO UNDISCOVERED EQUITIES, INC. AND KEVIN T. McKNIGHT**

I.

On August 4, 2014, the Securities and Exchange Commission ("Commission") instituted cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Undiscovered Equities, Inc. ("Undiscovered Equities") and Kevin T. McKnight ("McKnight," and collectively with Undiscovered Equities, "Respondents").

II.

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 admit (i) the Commission's jurisdiction over them and the subject matter of these proceedings and (ii) the facts set forth in Section VI.A-C of the Offer and incorporated by reference herein. Based on the foregoing, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act ("Order"), as set forth below.

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III.

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

A. RESPONDENTS

1. Undiscovered Equities is a Florida corporation based in Boca Raton, Florida. It provides public relations and other promotional services to small-cap publicly-traded companies.

2. McKnight resides in Boca Raton, Florida. McKnight is the President and owner of Undiscovered Equities.

B. OTHER RELEVANT PERSONS AND ENTITIES

3. Respondent Houston American Energy Corp. ("Houston American") is a Delaware corporation headquartered in Houston, Texas.

4. Respondent John F. Terwilliger ("Terwilliger") was Houston American's President and Chief Executive Officer at all relevant times.

5. The entity described herein as the "Operator" is a division of a South Korean conglomerate based in Seoul, South Korea.

C. THE RELEVANT CONDUCT

6. In November 2009, Houston American entered into a consulting agreement with Undiscovered Equities (the "Agreement").

7. The Agreement provided that Undiscovered Equities would assist in "the implementation and maintenance of an ongoing program to increase the investment community's awareness" of Houston American. In exchange, Houston American agreed to pay Undiscovered Equities $20,000 per month for at least six months.

8. Beginning in November 2009, Undiscovered Equities posted to its website and distributed to its subscribers a series of promotional articles about Houston American and Houston American's investment in the CPO-4 block, an oil and gas exploration and production area in Colombia's Llanos Basin. On December 31, 2009, Undiscovered Equities posted its list of "Top Picks for 2010," which included Houston American. The posting stated that "[*the*

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

Operator] believes the CPO 4 Block has over 100 viable drilling locations with estimated recoverable reserves of 1-4 billion barrels" (emphasis added).

9. Undiscovered Equities repeated these claims about the Operator's "belief" in a series of posts over the course of the next three months. Undiscovered Equities also posted anonymous messages to internet message boards for Houston American that directed potential investors back to the articles about Houston American on Undiscovered Equities' website.

10. On its website, and in the promotional articles, in the form distributed to the subscribers, Undiscovered Equities and McKnight disclosed that Undiscovered Equities was compensated by Houston American but did not disclose the amount of compensation it received. The anonymous posts to internet message boards did not disclose any information about the fact or amount of compensation that Undiscovered Equities received from Houston American.

11. As a result of the conduct described above, Respondents violated Section 17(b) of the Securities Act.

UNDERTAKING

For a period of five (5) years from the date of this Order, McKnight shall forgo receiving or agreeing to receive any form of compensation or consideration, directly or indirectly, from any issuer, underwriter, or dealer, for directly or indirectly publishing, giving publicity to, or circulating any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security. This undertaking includes, but is not limited to, doing any of the above-proscribed activities through any entity owned or controlled by McKnight.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, it is hereby **ORDERED** that:

A. Respondents cease and desist from committing or causing any violations and any future violations of Section 17(b) of the Securities Act.

B. McKnight shall comply with the undertaking set forth in Section III above.

C. McKnight shall pay a civil penalty of $22,500 to the Securities and Exchange Commission. Payment shall be made in the following installments: (i) $7500 shall be paid within ten (10) days of the date of this Order and (ii) the remaining $15,000 shall be paid within one (1) year of the date of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance, 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) Respondents may make direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(2) 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 the payee as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald Hodgkins, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-6010.

D. The Commission will hold funds paid in this proceeding in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, in accordance with Exchange Act Section 21F(g)(3), transfer them to the general fund of 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 ("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 a Fair Fund is created, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further **ORDERED** that for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S. C. §523, the findings in the Order are true and admitted by McKnight, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by McKnight 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 McKnight 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.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9755 / April 23, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74799 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16509

In the Matter of **EDWARD M. DASPIN, a/k/a "EDWARD (ED) MICHAEL"; LUIGI AGOSTINI; and LAWRENCE R. LUX,** **Respondents.**	**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**

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 Edward M. Daspin, Luigi Agostini and Lawrence R. Lux ("Daspin", "Agostini", "Lux" or collectively "Respondents").

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II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

1. Daspin, Agostini, and Lux participated in the fraudulent unregistered offerings of the securities of Worldwide Mixed Martial Arts Sports, Inc. ("WMMA") and an affiliate, WMMA Distribution, Inc. ("WMMA Distribution"),[1] start-up companies formed to establish an international league of mixed martial arts tournaments that would generate digital content and sell branded products.

2. From December 2010 through approximately June 2012 (the "relevant period"), WMMA and WMMA Distribution raised a total of $2.47 million from seven investors, of which at least $2 million was raised fraudulently. Daspin, who orchestrated the fraud, targeted unemployed professionals whom he lured in with offers of executive-level positions at the Companies. Typically it was only after prospects arrived for a "job interview" that they learned that they would be required to make a substantial investment as a condition of obtaining employment and receiving a salary.

3. Daspin made numerous false representations during these interviews regarding the financial condition of the Companies, including that they were well-funded when they were in fact barely surviving from one investment to the next. He also falsely represented that everyone working at the Companies was an investor and had "skin in the game." He also used an alias and made sure that prospective investors did not learn his true identity until they were on the verge of making an investment, to delay disclosure of his prior bankruptcy fraud conviction and decrease the likelihood they would learn of his recent failed business ventures before investing.

4. Daspin also falsely presented himself to investors as only a consultant to the Companies, when in reality he had substantial control over most the Companies' most important decisions and functions, including hiring, soliciting investments, drafting the Companies' private placement memorandums ("PPMs"), and negotiating contracts, and effectively controlled the Companies' bank accounts. Daspin also failed to disclose that his wife held a controlling interest in the Companies.

5. Daspin also caused the PPMs to contain material misrepresentations and omissions about an email and telephone marketing database purportedly run by International Marketing Corporations, Inc. ("IMC"), for which WMMA had contracted. The PPMs stated that the IMC database contained 840 million email addresses and Daspin held out the database, both in the PPMs and in his in-person solicitation of investors, as the centerpiece of the Companies' marketing strategy. He came up with a baseless $82 million valuation of the IMC database and insisted, over

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[1] WMMA, WMMA Distribution, and other affiliated companies identified below are hereafter collectively referred to as the "WMMA Companies," or the "Companies."

strong objections by employees and officers of the Companies, that it be included in WMMA's PPM dated January 5, 2012 to inflate WMMA's almost non-existent assets and lure in more investors. He also caused the Companies' PPMs to fail to disclose that the Companies had performed no due diligence on the IMC database and had no basis to believe that it would be of any real value to the Companies. Daspin also caused the PPMs to conceal his wife's controlling interest in the Companies.

6. The offerings of WMMA and WMMA Distribution securities were not registered with the Commission. In addition, Daspin and Lux acted as unregistered brokers by, among other things, actively soliciting investments in those securities, providing prospective investors with advice as to the merits of investments, and receiving compensation based on the sale of those securities.

7. Agostini and Lux enabled Daspin's fraud by presenting themselves to prospective investors as two of the Companies' three directors and, respectively, the Companies' executive chairman of the board and CEO, when in reality they and the Companies' third director deferred to Daspin on all significant matters. Agostini and Lux were fully aware of Daspin's wife's ownership of a controlling interest in the Companies and Daspin's true role but allowed the Companies to disseminate PPMs to prospective investors that failed to adequately disclose these facts and contained material misrepresentations and omissions regarding the IMC contract.

8. The Companies never generated any revenue and quickly burned through the investors' funds. After mounting a spectacularly unsuccessful mixed martial arts event in March 2012, the Companies descended into acrimony and litigation and are now defunct.

9. As a result of their fraudulent conduct, Daspin violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, including by 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; Lux violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Agostini committed or caused violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. As a result of their unregistered brokerage activity, Daspin and Lux violated Section 15(a) of the Exchange Act. As a result of their participation in the unregistered offerings of securities of WMMA and WMMA Distribution, Daspin and Lux violated Sections 5(a) and 5(c) of the Securities Act.

RESPONDENTS

10. **Edward Michael Daspin,** age 77, founded and for all practical purposes controlled the Companies. In 1978, Daspin was convicted of bankruptcy fraud for concealing from the bankruptcy trustee assets of a bankrupt company he had controlled; he was sentenced to eighteen months in prison. United States v. Edward Michael Daspin, 77 Crim. 00238 (D.N.J.) and United States v. Michael Daspin, 77 Crim. 0196 (S.D.N.Y.). Daspin resides in Boonton, New Jersey. Daspin has never been registered with the Commission as a broker-dealer or associated with a registered broker-dealer.

11. **Luigi Agostini,** 38, was a director and the executive chairman of the board of each of the Companies. Agostini resides in Jersey City, New Jersey.

12. **Lawrence R. Lux,** age 55, was a director and CEO of each of the Companies. Lux was briefly associated with a registered broker-dealer from December 2005 to April 2006, but otherwise has never been associated with a registered broker-dealer or registered with the Commission as a broker-dealer.

RELATED ENTITIES AND INDIVIDUALS

A. The WMMA Companies

13. **Worldwide Mixed Martial Arts Sports, Inc. ("WMMA")** was organized under the laws of Florida and initially was a wholly-owned subsidiary of WMMA Holdings. WMMA was formed for the purpose of creating an international league of mixed martial arts tournaments from which it could produce digital content to market and sell through its sister company, WMMA Distribution.

14. **WMMA Distribution, Inc. ("WMMA Distribution"),** f/k/a American Graphics Communication and Distribution Services, Inc. ("AGCDS"), was organized under the laws of Nevada and was a wholly-owned subsidiary of WMMA Holdings. WMMA Distribution was created for the purpose of distributing WMMA-branded digital content and related products. During the relevant period, the directors and senior officers of WMMA Distribution were the same as those for WMMA.

15. **WMMA Holdings, Inc. ("WMMA Holdings")** is the holding company for WMMA and WMMA Distribution and was organized under the laws of Nevada. WMMA Holdings held majority interests in WMMA and WMMA Distribution. At all relevant times, Daspin's wife held a controlling interest in WMMA Holdings.

B. The Consulting Companies

16. **Consultants for Business & Industry, Inc. ("CBI")** was organized under the laws of New Jersey and at all relevant times was wholly owned by Daspin's wife. CBI is the consulting company through which, directly or through MacKenzie Mergers & Acquisitions, Daspin provided services to the Companies.

17. **MacKenzie Mergers & Acquisitions ("MacKenzie")** is private company organized under the laws of Florida. In early 2011, MacKenzie acquired CBI's Consulting Agreement with the Companies and Daspin was designated a Senior Vice President of MacKenzie.

FACTS

A. Background

18. In April 2010, Daspin decided to start a new business capitalizing on the growing popularity of mixed martial arts. The Companies were founded in Daspin's basement, where they operated until they relocated to commercial office space in Little Falls, New Jersey. As conceived and structured by Daspin, WMMA would contract with local promoters to organize mixed martial arts tournaments around the world and create digital content and branded merchandise and WMMA Distribution would sell the content and merchandise, via cable television contracts and online viewing and product sales.

19. WMMA Holdings held the controlling interest in WMMA and WMMA Distribution, and the controlling interest in WMMA Holdings was held by three limited partnerships controlled by Daspin's wife. Daspin was the architect of this corporate structure.

20. Daspin enlisted Agostini, a friend of his son's, to serve as executive chairman of each of the Companies' boards of directors. Agostini had worked with Daspin at two of Daspin's prior failed ventures; at one of them Agostini was also held out as the company's chairman.

21. Daspin also recruited Lawrence Lux to serve as a director and CEO of WMMA and WMMA Distribution, and a director of WMMA Holdings. Lux was previously involved in another Daspin venture, a purported private equity company, of which Daspin was the senior partner. According to WMMA's and WMMA Distribution's PPMs, Lux had an expertise in internet marketing, had been involved with several internet start-ups, and had experience in raising capital for start-ups.

22. To obtain the initial working capital, Daspin approached a third individual, a mixed martial arts fan, who invested a total of $333,333 in December 2010 and April 2011 and was named a director and the president of WMMA and WMMA Distribution, and a director of WMMA Holdings ("the third director").

23. Daspin also recruited a former associate, who had worked with Daspin at several prior ventures, to draft contracts and other legal documents, including portions of the PPMs.

B. The Consulting Agreement

24. Rather than identify himself as an officer, director, or significant shareholder of the Companies, Daspin arranged to be retained as a "consultant" to the Companies. Daspin also arranged a series of contracts between CBI, and later MacKenzie, and the Companies, by which the Companies delegated their most important business and management functions to Daspin.

25. For example, on November 30, 2010, Daspin caused CBI to enter into an agreement with WMMA Holdings and WMMA (the "Consulting Agreement"). The Consulting Agreement provided CBI with the "exclusive right" to provide the Companies with services related to "human

resources," "deal-making," "raising equity," "developing strategic business, action and operating plans," and structuring "mergers and acquisitions." Later versions of the Consulting Agreement, including the December 15, 2010 Consulting Agreement, similarly provided that CBI was to provide the Companies with a broad range of "management advisory services," including: (a) "Executive recruiting;" (b) "Financial Advisory services pertaining to raising capital from third party investors" and (c) "Other management advisory services pertaining to their operations."

26. In the first half of 2011, CBI's Consulting Agreement with the Companies was assigned to MacKenzie and Daspin agreed to become a Senior Vice President of MacKenzie and continue to provide the services covered by the Consulting Agreement in return for receiving payments from the Companies through MacKenzie. Specifically, MacKenzie agreed to pay CBI 95% of the first $350,000 it received under the Consulting Agreement and to pay CBI 50% of anything over $350,000. CBI retained the right to have the Consulting Agreement assigned back to it.

27. All the iterations of the Consulting Agreement provided for substantial remuneration to Daspin through CBI, and later MacKenzie. For example, the December 2010 Consulting Agreement entitled CBI to a $25,000 fee (payable in installments) for each "sweat-equity" (i.e. non-investing) employee it recruited (plus 5% of the employee's compensation in excess of $125,000 annually for a period of five years). For successfully soliciting employees who invested in the Companies, CBI was entitled to an immediate minimum payment of $25,000, or 25% of the employee's first year salary, whichever was greater (plus 5% of the employee's compensation in excess of $125,000 a year, continuing indefinitely). [2]

28. Each of the six employees who invested in the Companies in 2011 and 2012 were assigned an annual salary of $150,000, thereby entitling MacKenzie, which by then had been assigned the Consulting Agreement, a commission of $37,500 for each employee recruited who purchased stock of WMMA or WMMA Distribution, a minimum of $12,500 more than it earned for recruiting employees who did not invest, plus the right to receive five percent of investor-employees' compensation over $125,000 indefinitely. Thus, Daspin received greater financial compensation for recruiting employees who invested in the Companies than for employees who did not.

29. The Consulting Agreement also provided that CBI would be paid $25,000 for each contract or transaction it negotiated, plus two percent of the value of the transaction or contract as such funds became available, payable on a monthly basis for a period of five years from the contract date. For other services, CBI employees and consultants were to be paid hourly fees ranging from $200 to $350 per hour.

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[2] All of the investors were employees or an officer and director of one or more of the Companies, but not all of the Companies' employees and officers and directors were investors.

30. Accordingly, through the Consulting Agreement, Daspin effectively operated as the Companies' CEO, with authority to make virtually every important decision, including decisions about the hiring of employees and executives, capital raising, negotiating contracts and transactions with third parties.

31. The Consulting Agreement contained no restrictions, procedural or substantive, on CBI's, and thus Daspin's, authority concerning the services to be provided under the contract and no one at the Companies was assigned responsibility for supervising CBI's, and thus Daspin's, actions under the Consulting Agreement.

C. <u>Oral Misrepresentations and Omissions in Soliciting Investors</u>

32. From September 2011 through March 2012, Daspin fraudulently raised $2,037,000 from six investors. Three investors invested a total of $698,000 in WMMA and $538,000 in AGCDS (WMMA Distribution's predecessor) in the fall of 2011 after being solicited by Daspin, who told them, among other things, to diversify their investments by investing in both companies, and provided them with copies of the WMMA PPM dated July 31, 2011 and the AGCDS PPM dated July 31, 2011.

33. Three additional investors invested a total of $438,000 in WMMA and $363,000 in WMMA Distribution after they were solicited by Daspin, who told them to diversify their investments by investing in both companies. Two of those individuals made their investments after being provided copies of the WMMA PPM dated January 5, 2012, and the WMMA Distribution PPM dated January 12, 2012.

34. In total, $1,486,000 was raised through the sale of WMMA stock, approximately $1,236,000 of which was raised fraudulently and $901,000 was raised through the sale of stock of AGCDS and WMMA Distribution, all of which was raised fraudulently.

35. Under the Consulting Agreements, Daspin was responsible for hiring and capital raising for the Companies. Daspin combined the two: raising almost all of the Companies' financing from employees in connection with their hiring. When looking for investors, Daspin targeted unemployed mid-level finance and technology professionals. He did so by having the Companies post advertisements on employment websites such as <u>www.sixfigurejobs.com</u>. Daspin's wife reviewed applications posted on the website in response to these advertisements, and on other job-hunting websites, and provided Daspin with the resumes and applications she considered the most promising. Interested prospects were then interviewed by telephone or Skype for supposedly executive positions.

36. Typically, the applicants were not told during these initial screening interviews that they would be required to make an investment, much less an investment of hundreds of thousands of dollars, to be hired and paid a "salary," which in fact was merely a (partial) repayment of their investment. After the unsuspecting applicants were lured to the Companies' offices in suburban New Jersey for a second round "job interview," Daspin lead the negotiations and solicited them to make an investment in the Companies.

37. To convince them to invest, Daspin falsely told a number of the prospective investors that everyone who worked at the Companies had invested or had "skin in the game," leading these prospects to believe that they would also have to make an investment to get a job. In addition, Daspin pressured the prospects to invest as much as possible, telling them that increasing their investment was a way to boost their salary and thus increase their draw against salary during the start-up phase, under the Companies' so-called "forward stock redemption program."[3]

38. When soliciting investments, Daspin used an alias, Edward (or Ed) Michael, to conceal, or delay disclosure of, his criminal record and history of failed ventures. It was only after the prospective investors signed a required non-disclosure agreement and were on the verge of investing that they were told Daspin's real name. Daspin did this to delay disclosure of his criminal conviction and, as a practical matter, the disclosure came too late. The disclosure of Daspin's true identity often occurred in a high-pressure setting where the prospective investor-employee was given various employment and investment-related documents to sign and was expected to turn over a check for his or her investment. The last minute disclosure was designed to deprive prospective investors of a reasonable opportunity to conduct due diligence on Daspin before making their investment.

39. Daspin also falsely presented himself to prospective investors as only a consultant to the Companies, when in reality, as discussed above, he had substantial input into, and often exercised ultimate control over, most important business decisions and actions of WMMA, including hiring all employees, soliciting all investors, drafting and dissemination of the Companies' PPMs, negotiating transactions and contracts on behalf of the Companies, controlling the Companies' bank accounts and making numerous other management decisions on behalf of the Companies. Notwithstanding the directors' exalted titles, neither they nor anyone else at the Companies was charged with supervising CBI, and therefore, Daspin in the exercise of his broad ranging powers under the so-called Consulting Agreement.

40. In soliciting investors, Daspin also failed to disclose the sizeable amount of monies the Companies already owed him, through CBI and MacKenzie, based on the fees earned to date – approximately $827,000 as of December 2011–which could have bankrupted the Companies.

41. Daspin also made false representations during these solicitations about the size of investments in, and the financial condition of, the Companies, including telling various investors,

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[3] Under the terms of their employment and investment agreements, the investor-employee' salaries would accrue, but would not be paid until certain profitability targets were achieved. Investor-employees, however, could receive a monthly draw before the targets were met pursuant to a "stock repurchase program" under which the Companies would buy back a small, fixed, percentage of the investor-employee's stock each month. Hence, to receive any payment for their work before the Companies became profitable, employees had to invest.

in substance, that WMMA Holdings had $100 million and would subsidize the Companies, that a company referred to variously as "Ford" or a car company had committed $20 million to the Companies, that the Companies had over $30 million cash on hand, that the Companies were well-funded and had sufficient cash on hand to cover ongoing expenses, that the third director had invested $500,000, and that the Companies had run profitable mixed martial arts events in the past. When pressed about the amount of cash on hand, Daspin at times evaded the question and referred prospective investors to the PPM or assured them that the Companies were well-funded.

D. Misrepresentations to Prospective Investors in the PPMS

i. Misrepresentation of Daspin's Role at the Companies

42. The PPMs identified Agostini as the Executive Chairman of each of the Companies' board of directors and identified Lux and the third director as the Companies' two other directors and, respectively, CEO and president of each of the Companies. The PPMs also identified other officers and employees, but neither Daspin nor his wife's names appear in the PPMs. During the employment application/investment solicitation process, prospective investors were told that Daspin was only a consultant to the Companies and that Agostini, Lux, and the third director were the Companies' directors and senior officers.

43. Daspin took steps to ensure that his name, and his role and his wife's controlling interest in the Companies, were kept out of the PPMs. Specifically, he devised what amounted to a sham transaction to create the illusion that the shares his wife owned were controlled by the Companies' directors. When the Companies were first formed, shares representing a controlling interest in WMMA Holdings were issued to three family partnerships owned and controlled by Daspin's wife. In or about December 2010, for nominal consideration, the partnerships transferred the stock they held to the directors, who agreed to hold the shares in trust for the partnerships. However, as part of the transactions, the directors gave the partnerships a warrant to repurchase the shares upon two days' written notice and the payment of the nominal strike price. Thus, although the directors ostensibly controlled a majority interest in the Companies throughout the relevant period, Daspin could immediately cause his wife's partnerships to exercise the warrants and buy back her controlling interest. Moreover, the directors held the stock subject to a fiduciary duty to Daspin's wife and her partnerships.

44. In reality, Daspin exercised ultimate control over virtually every important decision of the Companies. He was able to exert this control both through the Consulting Agreement, and because his wife effectively owned a majority of the Companies' stock. In addition, two of the three directors and senior officers had no relevant business experience. Agostini, who had previously worked as a disc jockey and in music production, repeatedly deferred to Daspin for important business decisions, as did Lux and the third director.

45. Daspin also exercised control over the Companies' funds. Agostini had signatory authority (along with Daspin's wife) over the Companies' main bank accounts and signed almost all the checks drawn on those accounts. However, he made significant payments only with Daspin's approval. At one point, several of the investors who had been hired to be the Companies'

ostensible finance officers tried to obtain signatory authority over the Companies' bank accounts and to have the Companies require that one of them co-sign all checks. A board resolution was prepared to effect that change, but Agostini told the board that Daspin had refused to permit him to share signatory authority over the checking accounts. At Daspin's direction, Agostini also strictly limited the finance officers' access to the Companies' bank account records, impeding their ability to even review the Companies' expenditures.

46. Daspin also directed that the PPMs contain no disclosure of his wife's stock ownership. WMMA's July 31, 2011 PPM stated that WMMA Holdings owned 91.5% of WMMA's stock, and that eleven individuals who owned most of the other 8.5% of WMMA's stock also owned unspecified percentages of WMMA Holdings. WMMA's January 5, 2012 PPM stated that each of the three directors held 22.54% of the stock of WMMA Holdings and its subsidiaries as a "trustee," without identifying the trust beneficiaries. An earlier draft of the PPM had contained disclosure of Daspin's wife's control of the Companies' stock through the partnerships, but at Daspin's direction the disclosure was removed. AGCDS's July 31, 2011 PPM and WMMA Distributions' January 12, 2012 PPM similarly failed to disclose Daspin's wife's controlling interest in the Companies.

ii. Misrepresentations About the IMC Contract

47. According to the PPMs, the Companies would use the IMC database to market and sell tickets to sponsored events, as well as all of their digital content and related products. The IMC contract was the core of the Companies' business plan.

a. The Misleading Description of the IMC Contract

48. In describing the IMC contract, the PPMs stated:

> WMMA has signed a long term strategic alliance agreement with [IMC]. . . . IMC is one of the foremost multi-level marketing and database marketing companies in the world and, has joint ventures with hotels, timeshares and has thousands of dollars of free product and services discounts which can be used as part of its marketing programs to provide MMA spectators with value-added benefits that they are not now enjoying by watching other competitor's shows.
>
> . . . .
>
> IMC has over One Hundred and Thirty Million (130,000,000) U.S. mobile phone numbers for text messaging and invitations; as well as access to Four Million (4,000,000) websites of prospective spectators. In addition, IMC has over Eight Hundred and Forty Million (840,000,000) opt-in e-mail addresses and One Hundred Million (100,000,000) press release outlets.
>
> . . . .

49. The PPMs further stated that out of a two billion-person potential market in the sixteen countries where WMMA planned to operate, "IMC is estimated to have about Twenty Five Percent of the WMMA MMA spectator market in its proprietary database."

50. The PPMs failed to disclose facts that, at a minimum, raised substantial questions about the truth of these statements and whether the database would be of any real use to the Companies. The PPMs failed to disclose that no one associated with the Companies had tested the database or had any idea how many of the addresses in it were still valid, not to mention how many were for people within the target audience for mixed martial arts. The PPMs also failed to disclose that the effectiveness of the database depended in part on the Companies having a working website for email marketing – not only did the Companies not have a working website during the period in which most of the investments were made, but their efforts to create one had repeatedly come up short.

51. Daspin authored the narrative descriptions in the PPMs regarding the IMC contract and database and insisted upon their inclusion over objections that the descriptions were misleading because (a) WMMA had not obtained any demographic information about the database, (b) the database had not been tested, and (c) IMC had the right to cancel the contract on short notice.

b. <u>The Unreasonable Valuations of the IMC Contract</u>

52. The WMMA PPMs also contained baseless and increasingly fantastic valuations of the IMC contract. The July 31, 2011 WMMA PPM represented that MacKenzie had valued the IMC contract at $5 million, a valuation for which there was no reasonable basis. Not content with the excessive $5 million valuation, Daspin insisted on substantially increasing the valuation in later versions of the WMMA PPM to inflate the Companies' apparent value.

53. Accordingly, in the fall and winter of 2011, as he began raising money from investors, Daspin began to push for the inclusion of significantly higher valuations of the IMC contract in the WMMA PPM. He initially sought to inflate the valuation to approximately $160 million, but when that valuation met with stiff resistance from others within the Companies, he proposed an $82 million valuation. Despite strong objections by a number of Company officers and employees, Daspin insisted on including the $82 million valuation in the January 2012 WMMA PPM, which he used to solicit at least two additional investors.

54. Thus, at Daspin's insistence, the narrative portion of the January 2012 WMMA PPM included a representation that MacKenzie had valued the IMC contract at $82 million – albeit not in accordance with GAAP – and that WMMA's board had approved the valuation and requested that it be included in the PPM.

55. At Daspin's insistence, the January 2012 WMMA PPM also included a two-page, unaudited "Consolidated Balance Sheet" which listed the IMC contract as an intangible asset valued at $82 million. A footnote to the $82 million entry on the balance sheet stated "[a]ppraised

value by MacKenzie M&A of 840 million double opt-in customer database (20 year exclusive contract)."

56. Daspin had no reasonable basis for the $82 million valuation he insisted be included in the January 2012 WMMA PPM. Neither he nor anyone else associated with the Companies conducted appropriate due diligence on the IMC database. As Daspin well knew, no one had verified the existence of the database, tested it, obtained any demographic information about the individuals in the database, or confirmed how many of the email addresses and mobile phone numbers in the database were current.

57. Daspin also knew that the effectiveness and value of the database was entirely dependent on the Companies having a functioning website through which individuals who received marketing emails or text messages could purchase tickets to sponsored events and related products, and to download or stream digital content, and he knew that WMMA's staff was still struggling to create an operational website when the January 2012 PPMs were provided to prospective investors.

c. Misrepresentations About Cash on Hand

58. The January 5, 2012 WMMA PPM contained a two page "Forecasted Consolidated Balance Sheet" for WMMA that contained an entry of $33,085,850 in cash for "Stub-Period 2011 (Charitable Event)." The term "stub-period" was not defined; the balance sheet bore a date of September 30, 2011, but it appeared at the bottom of the page and was not otherwise referenced. However, at no time did WMMA have $33 million in cash and there was no reasonable basis to believe that a charitable event in 2011 would generate $33,085,850 in cash. Daspin referred a number of investors who asked him how much cash was on hand to the PPM.

E. The Offerings of WWMA and WMMA Distribution Securities Were Not Registered

59. The offerings of WMMA and WMMA Distribution's securities were not registered with the Commission.

60. Each offering sought to raise $20 million, and used means of general solicitation by placing advertisements on internet employment websites. Although ostensibly conducted as private placements pursuant to Section 4(2) of the Securities Act and Rule 506, no attempt was made to verify the investors' claimed financial condition. At least three investors were not accredited and were not provided with an audited balance sheet or any other audited financial information about WMMA or WMMA Distribution.

F. Daspin's and Lux's Receipt of Commissions

61. In accordance with the Consulting Agreement, the Companies paid CBI approximately $135,000, and paid MacKenzie approximately $247,000 for bringing in investments. Daspin received a substantial portion of this money. Under the Consulting Agreement, other individuals who assisted in obtaining investments from new investors were also

entitled to a small percentage of the commissions CBI and MacKenzie earned on those investments. For his assistance in recruiting investors, Lux received approximately $9,000.

62. Neither Daspin nor Lux, nor any of the other individuals who received commissions on investments, were associated with a registered broker-dealer during the relevant period.

G. The Roles of Agostini and Lux

63. Agostini and Lux served essential roles in Daspin's fraud, enabling Daspin to control the Companies while maintaining the illusion that he was only a consultant. Although they were ostensibly two of the Companies' three directors and senior officers, on all important matters, they either deferred to Daspin or acquiesced in his decisions. Moreover, they signed the Consulting Agreement delegating virtually all of the Companies' important decisions to Daspin, including raising capital from investors. Agostini and Lux also participated in the sham transactions described in paragraph 43, above, in which Daspin caused his wife's 67% interest in the Companies' stock to be held by Agostini, Lux and the third director "in trust," but Daspin's wife was issued warrants by which she could buy back her controlling interest in the Companies for nominal consideration and on only two days' notice. Agostini and Lux thereby assisted Daspin's scheme to conceal from investors his control of the Companies.

64. Agostini and Lux had both been involved in some of Daspin's prior ventures in which Daspin had controlled the enterprise although ostensibly serving as an outside "consultant." Agostini and Lux were fully aware of the true ownership structure of the Companies and Daspin's control. They were also fully aware of Daspin's criminal conviction and string of failed ventures.

65. In addition, Agostini arranged for all the payments to Daspin (directly or through MacKenzie and CBI) and made other substantial payments only as directed by Daspin. Moreover, Agostini controlled access to the bank account records and impeded the efforts of the Companies' finance officers to control, or even review, the Companies' expenditures.

66. Lux knew that there was no reasonable basis for the descriptions of the IMC database in the PPMs and the $82 million valuation of the IMC contract in the January 2012 WMMA PPM. Moreover, he participated in the solicitation of investors and thus witnessed Daspin's active concealment of his true identity until late in the solicitation process.

H. The End of the Companies

67. In March 2012, the Companies produced a charity fundraising mixed martial arts event in El Paso, Texas to generate brand recognition for WMMA. Instead, the El Paso event was the death knell for the Companies, resulting in a loss of approximately $500,000 and consuming most of their remaining cash. By June 2012, if not sooner, the Companies had run out of cash, and ceased doing business.

VIOLATIONS

68. As a result of the fraudulent conduct described above, Daspin willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

69. As a result of the fraudulent conduct described above, Lux willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

70. As a result of the fraudulent conduct described above, Agostini caused violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

71. As a result of the fraudulent conduct described above, Daspin acted through or by means of the Companies and the directors to make material misstatements and omissions in connection with the purchase or sale of securities, and, as a result, willfully violated Sections 20(b) and 10(b) of the Exchange Act and Rule 10b-5 thereunder.

72. As a result of their participation in the unregistered offerings of securities for which no exemption from registration was available, as described above, Daspin and Lux willfully violated Sections 5(a) and 5(c) of the Securities Act.

73. As a result of their unregistered brokerage activity described above, Daspin and Lux willfully violated Section 15(a) of the Exchange 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 Respondents 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 Daspin should be ordered to cease and desist from committing or causing violations and any future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act and Section 10(b), 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 Section 15(a) of the Exchange Act, and whether Respondent Lux should be ordered to cease and desist from committing or causing violations and any future violations of Sections 5(a), 5(c), 17(a)(2) and 17(a)(3) of the Securities Act, and Section 15(a) of the Exchange Act, and whether Agostini should be ordered to cease and desist from committing or causing violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

C. What, if any, remedial action is appropriate in the public interest against Respondents Daspin and Lux pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

D. Whether, pursuant to Sections 8A of the Securities Act and Section 21C of the Exchange Act, Respondents Daspin, Lux and Agostini should be ordered to pay disgorgement and civil penalties.

IV.

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

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

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, they 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 as provided for in the Commission's Rules of Practice.

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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74798 / April 23, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4069 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16508

In the Matter of **TRACY MORGAN SPAETH,** **Respondent.**	**ORDER INSTITUTING ADMINSTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) 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)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Tracy Morgan Spaeth ("Spaeth" 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 contained in Sections III.2 and III.3, below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) 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. Spaeth, 48 years old, resides in Lubbock, Texas. From July 2010 through October 2013, Spaeth was employed by and associated with Uncommon Financial Services, LC ("UFS"), an entity registered with the State of Texas as an investment adviser. On August 10, 2010, Spaeth registered with the Texas Securities Commissioner as an investment adviser representative of UFS. On May 23, 2013, the Texas Securities Commissioner issued a disciplinary order whereby Spaeth's registration as an investment adviser representative was suspended for a period of two years. Between 1989 and 2010, Spaeth was a registered representative with various registered broker-dealers. On September 7, 2012, Spaeth consented to a two-year suspension from association with all FINRA members in all capacities and a $5,000 fine.

2. On December 4, 2014, Spaeth entered a plea of *nolo contendere*, and was found guilty of one count of selling securities without registration in violation of Section 581-29(B) of the Texas Securities Code, before the 364th District Court in Lubbock County, Texas, in the matter styled *The State of Texas v. Tracy Spaeth*, Action No. 2013-400,253 (Tx. 2014). On the same day, Spaeth was sentenced to 10 years confinement, but that sentence was suspended and Spaeth was placed on eight years of community supervision.

3. In his plea, Spaeth confessed to having engaged in a fraudulent practice by knowingly failing to disclose material facts in connection with the offer and sale of over $100,000 of securities; to having sold securities while not registered to sell securities in the State of Texas; and to having 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 the Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent be, and hereby is, barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74802 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-14950

In the Matter of CENTAUR MANAGEMENT CO. LLC Respondent.	ORDER DIRECTING DISBURSEMENT OF FAIR FUND

On May 17, 2013, pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103, the Commission issued a Notice of Proposed Plan of Distribution and Opportunity for Comment ("Notice") (Exchange Act Rel. No. 69604 (May 17, 2013)). The Notice provided all interested parties thirty (30) days to submit a comment on the Proposed Plan of Distribution ("Proposed Plan"). The Notice advised interested parties that they could obtain a copy of the Proposed Plan from the Commission's public website or by submitting a written request to Anik A. Shah, United States Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5631. All persons who desired to comment on the Proposed Plan could submit their comments, in writing, no later than thirty (30) days from the date of the Notice. The Commission received no comments on the Proposed Plan. On July 22, 2013, the Commission issued an Order Approving Plan of Distribution (Exchange Act Rel. No. 70015 (July 22, 2013)).

The Plan of Distribution ("Plan") provides for the distribution of the Fair Fund, comprised of $172,438 in disgorgement, $41,884 in prejudgment interest, and

$150,000 in civil penalty, less any federal, state or local taxes and costs and expenses of distributing the Fair Fund, when the Fund Administrator submits a list of payees with multiple identifiers and a "reasonable assurances letter" representing that the list of payees was compiled in accordance with the Plan, is accurate as to eligible recipients' names, addresses, and disbursement amounts, and provides all information necessary to make disbursements to each eligible recipient. The Fund Administrator has submitted to Commission staff the list of payees and a "reasonable assurances letter." Commission staff has reviewed the list of payees and "reasonable assurances letter" and requests that, pursuant to Rule 1101(b)(6) of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1101(b)(6), the Commission authorize the transfer of $232,650.68 from the Fair Fund to the escrow account for distribution in accordance with the Plan.

Accordingly, it is ORDERED that the Commission staff shall direct the transfer of $232,650.68 from the Fair Fund to the escrow account and that the Fund Administrator shall distribute such monies to eligible recipients as provided for in the Plan.

By the Commission.

Brent J. Fields
Secretary

By: Lynn M. Powalski
Deputy Secretary

Commissioner Gallagher
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74803 / April 23, 2015

Admin. Proc. File No. 3-15764

In the Matter of GARY L. MCDUFF	ORDER REMANDING FOR ADDITIONAL PROCEEDINGS

An administrative law judge barred Gary L. McDuff by summary disposition from associating with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934.[1] As explained below, we find that the existing record does not contain sufficient evidence to establish one of the statutory requirements for a proceeding under Exchange Act Section 15(b)(6) or to support a sanctions analysis. We therefore remand this matter to the law judge for further proceedings.

Exchange Act Section 15(b)(6) authorizes the Commission to determine whether a sanction is in the public interest if two statutory requirements are met: (i) the respondent is associated, is seeking to become associated, or, at the time of the alleged misconduct, was associated or was seeking to become associated with a broker or dealer, and (ii) the respondent meets at least one of several potential bases for a proceeding, including that respondent has been enjoined from engaging in or continuing any conduct or practice in connection with acting as a broker-dealer.[2] The law judge found that there was no genuine issue of material fact that these two prerequisites were met and determined that a collateral bar was in the public interest.

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1 *Gary L. McDuff*, Initial Decision Release No. 663, 2014 WL 4384138 (Sept. 5, 2014). McDuff appeals the law judge's initial decision, and the Division of Enforcement moves for summary affirmance.

2 *See* 15 U.S.C. § 78o(b)(6); *Martin R. Kaiden*, Securities 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."). A person who acts as an unregistered broker-dealer is "associated" with a broker-dealer for the purposes of Section 15(b). *See Tzemach David Netzer Korem*, Exchange Act Release No. 70044, 2013 WL 3864511, at *8 (July 26, 2013) (holding that
(continued...)

But the law judge erred when he found that there was no genuine issue of material fact concerning the first prerequisite. The law judge further erred when he based his sanctions determination on the allegations in a civil complaint on which McDuff defaulted and a superseding indictment on which a jury returned a general verdict. On the record before us, the allegations in neither document have the necessary preclusive effect to make those determinations.

I. The Commission instituted these proceedings against McDuff after he was enjoined by default judgment from violating the securities laws and was convicted in a related criminal proceeding.

The Commission instituted this follow-on proceeding on February 21, 2014, alleging that McDuff had been permanently enjoined by a U.S. district court from future violations of Securities Act Sections 5(a), 5(c), and 17(a);[3] Exchange Act Sections 10(b) and 15(a);[4] and Exchange Act Rule 10b-5.[5] The injunction stemmed from a civil complaint that the Commission filed on March 26, 2008.[6] The Commission alleged in the civil complaint that McDuff was the "mastermind" behind a wide-ranging scheme to defraud investors. McDuff allegedly created and operated Lancorp Financial Fund Business Trust ("Lancorp Fund"), an entity that McDuff misrepresented to investors as being an unregistered, closed-end, and non-diversified management investment company that invested solely in highly rated debt securities. But instead of investing in high-grade debt securities as promised, McDuff allegedly directed Lancorp Fund to invest in Megafund Corporation, a Ponzi scheme. McDuff also allegedly devised a scheme to circumvent a prohibition against Lancorp Fund's paying certain commissions by having an associate covertly pay McDuff and another associate more than $300,000.

McDuff failed to answer the complaint, and the Commission moved for default judgment. The district court granted the Commission's motion and enjoined McDuff from further violations

(...continued)

it is "well established that [the Commission is] authorized to sanction an associated person of an unregistered broker-dealer or investment adviser in a follow-on administrative proceeding"); *Vladislav Steven Zubkis*, Exchange Act Release No. 52876, 2005 WL 3299148, at *6 (Dec. 2, 2005) (barring an associated person of an unregistered broker-dealer from associating with any broker-dealer and from participating in any penny stock offering).

3 15 U.S.C. §§ 77e(a), 77e(c), 77q(a).

4 *Id.* §§ 78j(b), 78o(a).

5 17 C.F.R. § 240.10b-5.

6 Complaint, *SEC v. McDuff*, No. 3-08-cv-526 (N.D. Tex. Mar. 26, 2008).

of the federal securities laws and ordered him to disgorge $136,336 plus $65,004 in prejudgment interest and to pay a civil penalty of $125,000.[7] McDuff did not appeal.

On August 13, 2009, McDuff was indicted in a related criminal proceeding, based on his involvement in the Lancorp Fund and Megafund.[8] He was charged with laundering monetary instruments and conspiracy to commit wire fraud. A jury found McDuff guilty on both counts pursuant to a general jury verdict. On April 16, 2014, the district court sentenced McDuff to 300 months in prison and a three-year term of supervised release and ordered him to pay $6,563,179 in restitution. McDuff appealed his conviction; that appeal is pending before the U.S. Court of Appeals for the Fifth Circuit.

II. The law judge erred in relying on the default judgment as a basis for finding that McDuff acted as an unregistered broker or dealer at the time of his alleged misconduct.

After the Commission instituted these proceedings, McDuff and the Division both moved for summary disposition. The law judge denied McDuff's motion and granted the Division's motion, finding that there was no issue of material fact that McDuff had acted as an unregistered broker or dealer at the time of his alleged misconduct.[9] The law judge based this finding on "the district court's ruling that the Commission was entitled to a permanent injunction against McDuff for violating Exchange Act Section 15(a)(1) [which prohibits one from acting as an unregistered broker]."[10] The law judge also relied on two affidavits that McDuff introduced from alleged victims, which the law judge quoted as saying that McDuff "plac[ed] Lancorp Fund money into the Megafund."[11]

McDuff challenges the law judge's finding that he acted as a broker-dealer, claiming instead that he was merely another investor in the two funds. Normally a respondent in a follow-on proceeding cannot challenge a district court's earlier findings. But that is not necessarily the case where, as here, the underlying proceeding was decided by default. The Supreme Court has explained that, "[i]n the case of a judgment entered by . . . default, none of the issues is actually litigated. Therefore [issue preclusion, or collateral estoppel] does not apply with respect to any

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7 Final Default Judgment, *SEC v. McDuff*, No. 3:08-cv-526 (N.D. Tex. Feb. 22, 2013).

8 Superseding Indictment, *United States v. Reese*, No. 4:09-cr-90 (E.D. Tex. Aug. 13, 2009).

9 The law judge also found that McDuff did not dispute that he had been enjoined from future violations of the securities laws.

10 *McDuff*, 2014 WL 4384138, at *3 (citing 15 U.S.C. § 78o(a)(1) (providing that it is unlawful "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 one is a registered broker or dealer or associated with a registered broker or dealer)).

11 *Id.* at *3 (quoting affidavits in respondent's Exhibit 8).

issue in a subsequent action."[12] The district court's default judgment therefore does not, by itself, provide an adequate basis for finding that McDuff acted as an unregistered broker-dealer.[13]

Although the Commission has given preclusive effect to substantive findings that have *accompanied* the entry of default,[14] the record here contains no such additional evidence that establishes whether McDuff was "engaged in the business of effecting transactions in securities for the accounts of others."[15] The law judge quotes two affidavits as stating that McDuff placed Lancorp money into the Megafund, but the quotes are taken out of context. Both affidavits state that the affiants were "aware that . . . GARY MCDUFF [has] been, and [is] now being prosecuted for placing Lancorp Fund money into the Megafund, and losing it the same way [the affiants'] money was lost." The affiants therefore recite only the government's accusation that McDuff transferred money from one fund to another. And even if the affiants had personal knowledge of such a transfer, determining whether McDuff was acting as an unregistered broker-dealer involves the consideration of several factors in addition to his handling of funds.[16]

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[12] *Arizona v. California*, 530 U.S. 392, 414 (2000) (quoting RESTATEMENT (SECOND) OF JUDGMENTS, § 27 cmt. e, p. 257 (1982)).

[13] *Cf. Don Warner Reinhard*, Exchange Act Release No. 61506, 2010 WL 421305, at *4 (Feb. 4, 2010) ("*Reinhard I*") (remanding matter for further proceedings where initial decision relied on a default judgment as the basis for determining appropriate sanctions).

[14] *See, e.g., Harold F. Harris*, Exchange Act Release No. 53122A, 58 SEC 1118, 2006 WL 89510, at *5 (Jan. 13, 2006) (giving preclusive effect to findings of violations that, although "termed a default," were based on the district court's consideration of respondents' substantive defenses and specific findings of fact); *Thomas J. Donovan*, Exchange Act Release No. 52883, 58 SEC 1032, 2005 WL 3299159, at *4–5 (Dec. 5, 2005) (imposing sanctions based on a default injunction where the law judge conducted a hearing and accepted documents and testimony that related to the misconduct at issue and the public interest); *Lamb Bros., Inc.*, Exchange Act Release No. 14017, 46 SEC 1053, 1977 SEC LEXIS 715, at *12 (Oct. 3, 1977) (imposing sanctions based on a default injunction where the "allegations made in the injunctive suit [were] remade" in the administrative proceeding and "an evidentiary record with respect to those matters was developed").

[15] 15 U.S.C. § 78c(a)(4) (defining "broker"); *see also id.* § 78c(a)(5) (defining "dealer" generally as "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise").

[16] *See, e.g., SEC v. Bravata*, 3 F. Supp. 3d 638, 660 (E.D. Mich. 2014) (stating that "'[f]actors that may qualify an individual as a broker [include] regular participation in securities transactions, employment with the issuer of the securities, payment by commission as opposed to salary, history of selling the securities of other issuers, involvement in advice to investors and active recruitment of investors'" (quoting *SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005))); *SEC v. Kramer*, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. 2011) (stating that determining whether a person qualifies as a broker under Section 15(a) involves considering an array of non-exclusive factors); *Anthony Fields, CPA*, Exchange Act Release No. 74344, 2015 WL 728005, at *18

(continued...)

We accordingly remand this matter to the law judge to admit and consider additional evidence from the criminal proceeding or any other relevant source to determine whether McDuff was acting as a broker or dealer at the time of his misconduct.

III. The law judge erred in relying on allegations in the civil complaint and superseding indictment when determining that a collateral bar was in the public interest.

The law judge determined that a full collateral bar was in the public interest by relying on the allegations in the civil complaint and in the superseding indictment. Such allegations may, in certain circumstances, provide a basis for assessing whether sanctions are appropriate, but as discussed above, the allegations in the civil complaint do not have the necessary preclusive effect here. As explained below, nor do the allegations in the superseding indictment.

The law judge interpreted two Commission decisions—*Don Warner Reinhard II* and *Ross Mandell*—as allowing him to adopt allegations from an indictment without needing to "engage in a particularized collateral-estoppel analysis, as might be required in other contexts."[17] But in *Reinhard II*, we did not rely on an indictment when determining that a bar was in the public interest. We relied on a plea agreement, in which the respondent expressly "waived any objections he may have had to the facts set out in the latter agreement and became bound by the facts recited therein."[18] McDuff has not pleaded guilty, nor has he made other concessions or acknowledgements that might have preclusive effect here. And although we referenced a superseding indictment when conducting our sanctions analysis in *Mandell*, we did not hold that allegations in an indictment automatically have preclusive effect. Rather, we stated simply that our "*summary* of Mandell's conduct *draws from* the allegations in the superseding indictment underlying his criminal conviction."[19] Our analysis also referenced a district court order, which

(...continued)

(Feb. 20, 2015) (stating that "[a]ctivities that are indicative of being a broker include holding oneself out as a broker-dealer, recruiting or soliciting potential investors, handling client funds and securities, negotiating with issuers, and receiving transaction-based compensation").

17 *McDuff*, 2014 WL 4384138, at *5 n.10 (citing *Don Warner Reinhard*, Exchange Act Release No. 63720, 2011 WL 121451 (Jan. 14, 2011) ("*Reinhard II*") and *Ross Mandell*, Exchange Act Release No. 71668, 2014 WL 907416 (Mar. 7, 2014)).

18 *Reinhard II*, 2011 WL 121451, at *7 (citing *United States v. Lomeli-Mences*, 567 F.3d 501, 507 (9th Cir. 2009) (holding that defendant could not challenge facts on appeal after admitting to those facts in "both his written plea agreement and oral change of plea proceedings")); *cf. United States v. Newman*, 148 F.3d 871, 876 (7th Cir. 1998) (holding that defendant was deemed to have admitted facts in signed plea agreement and waived any subsequent challenge to them).

19 *Mandell*, 2014 WL 907416, at *2 n.13 (emphasis added) (citing Superseding Indictment, *United States v. Mandell*, No 1:09-cr-0062 (S.D.N.Y. Dec. 14, 2010)).

made express findings about what the jury would have concluded from the evidence presented at Mandell's criminal trial.[20]

Here, a jury convicted McDuff of conspiracy to commit wire fraud in a general verdict, which the jury could do without making a specific finding as to which, if any, of the alleged overt acts McDuff committed.[21] And although the jury also returned a general verdict that McDuff committed money laundering, that verdict generally establishes only that McDuff caused a Megafund-controlled account to transfer illegal proceeds to a Lancorp-controlled account with the intent to promote the wire fraud.[22] Under these circumstances, the law judge erred in relying on the allegations in the superseding indictment in his sanctions analysis.[23] Therefore, if the law judge first determines that the statutory basis for imposing remedial

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[20] *See id.* at *5 n.24 (citing Order Denying Motions for Acquittal or New Trial, *United States v. Mandell*, No 1:09-cr-0062 (S.D.N.Y. Nov. 2, 2011)).

[21] *See United States v. Jones*, 733 F.3d 574, 584 (5th Cir. 2013) (holding that conspiracy to commit wire fraud does not require that the defendant committed an overt act); *cf. United States v. Wainer*, 211 F.2d 669, 672 (7th Cir. 1954) (stating that, "[o]bviously a general verdict of guilty, or for that matter the entry of a plea of guilty, on a count for conspiracy does not determine which of the particular means charged in the indictment were used to effectuate the conspiracy").

[22] *See United States v. Valuck*, 286 F.3d 221, 225 (5th Cir. 2002) (stating that, to prove a conviction for money laundering under the relevant statute, the government must prove that "(1) the financial transaction in question involves the proceeds of unlawful activity, (2) the defendant had knowledge that the property involved in the financial transaction represented proceeds of an unlawful activity, and (3) the financial transaction was conducted with the intent to promote the carrying on of a specified unlawful activity").

[23] *Cf. Reinhard I*, 2010 WL 421305, at *4 (concluding that the Commission's sanctions analysis would be assisted by the introduction of additional evidence on remand where the law judge had relied on a default injunction when determining sanctions).

sanctions is met, we direct the law judge on remand to admit and consider additional evidence to determine whether imposing such sanctions against McDuff is in the public interest.

Accordingly, it is ORDERED that the Division's motion for summary affirmance is denied; and it is further

ORDERED that the initial decision entered against McDuff be vacated; and it is further

ORDERED that this case be remanded to the administrative law judge for further proceedings consistent with this order.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9759 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16511

In the Matter of **the Registration Statement of** **International Precious Metals, Inc.** **64040 Harvest Moon Road** **Desert Hot Springs, CA 92240** **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 November 7, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 2,000,000 common shares. The registration statement was amended on January 15, 2014 (together, the "Registration Statement"). The Registration Statement has not been declared effective.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent is a Nevada corporation headquartered in Desert Hot Springs, California.

B. MATERIAL MISSTATEMENTS AND OMISSIONS

2. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading concerning the funding of Respondent, and disclosures that Respondent has a sole officer and director contrasted with the collective actions taken by undisclosed control persons and/or promoters.

a. The Registration Statement states that the Respondent's sole officer and director "has advanced $25,100 to the company for expenses." This disclosure is false and misleading because Respondent's sole officer and director did not advance any money to Respondent.

b. The Registration Statement states that Respondent "issued 5,000,000 founder's shares to its Director [] for $5,000 in cash." This disclosure is false and misleading because Respondent's sole officer and director did not pay for his shares.

d. The Registration Statement states that Respondent has a sole officer and director. This disclosure is false and misleading because Respondent has undisclosed control persons and/or promoters, who are different than the sole officer and director listed in the Registration Statement. One of the undisclosed control persons and/or promoters:

i. drafted Respondent's business plan;
ii. selected Respondent's auditor;
iii. signed Respondent's bank documents listing his title as Respondent's president;
iv. authorized payments from Respondent's bank account to pay professionals that facilitated the filing of Respondent's Registration Statement, including professional fees to its accountant, auditor and attorney;
v. withdrew thousands of dollars of so-called consulting fees from Respondent's bank account;
vi. funded Respondent; and
vii. communicated with the law firm that facilitated Respondent's the filing of Respondent's Registration Statement providing it with draft responses to staff's comments to Respondent's Registration Statement.

e. The Registration Statement is false and misleading because it omits that in 2003, two of the undisclosed control persons and/or promoters were banned by the British Columbia Securities Commission for engaging in an unregistered distribution, unresolved conflicts of interest, and misrepresentations, among other things.

f. The Registration Statement states that Respondent's sole officer and director "will be devoting approximately 15 hours per week of his time to our operations." This disclosure is false and misleading because Respondent's sole officer and director has minimal involvement in – and spent little to no time on – Respondent's operations.

g. The Registration Statement states that "[t]here are no persons other than our sole officer [sic] and directors above that are expected by us to make a significant contribution to our business." This disclosure is false 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 May 13, 2015, in Hearing Room 2 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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9758 / April 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16510

In the Matter of the Registration Statement of Kismet, Inc. 1516 E. Tropicana Ave, Suite 155 Las Vegas, NV 89119 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 May 30, 2013, Kismet, Inc. ("Respondent") filed a Form S-1 registration statement seeking to register the offer and sale of 4 million common shares for $0.05 per share. The registration statement was amended on November 22, 2013, December 13, 2013, January 14, 2014, and January 29, 2014 (together, the "Registration Statement"). The Registration Statement has not been declared effective.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent is a Nevada corporation headquartered in Las Vegas, Nevada.

B. MATERIAL MISSTATEMENTS AND OMISSIONS

2. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading concerning disclosures that Respondent has a sole officer and director contrasted with the collective actions taken by undisclosed control persons and/or promoters.

3. The Registration Statement states that Respondent "is entirely dependent on the efforts of [Respondent's sole officer and director] because of the time and effort he devotes to [Respondent]." The Registration Statement further states that "[w]e currently rely on our sole officer and director, [ ], to manage all aspects of our business. These disclosures are false and misleading because undisclosed control persons and/or promoters have:

a. opened Respondent's bank account and is the sole signatory on Respondent's bank account;
b. incorporated Respondent and paid its incorporation and registered agent fees;
c. retained the law firm that facilitated the filing of Respondent's Registration Statement;
d. used a personal checking account to pay the $5,000 attorney's fee to the law firm that facilitated the filing of Respondent's Registration Statement;
e. established Respondent's corporate telephone number; and
f. maintained a credit card jointly with Kismet, Inc.

C. FAILURE TO COOPERATE WITH SECTION 8(e) EXAMINATION

4. On February 24, 2014 the staff issued a subpoena to Respondent for the production of documents. The staff re-sent the February 24, 2014 subpoena to Respondent on March 13, April 2, and June 26, 2014. Respondent has failed to respond to that subpoena.

5. On June 23, 2014, the staff issued a subpoena to Respondent's sole officer and director for testimony. The staff re-issued the subpoena on June 26, and on July 11, 2014 re-sent the June 23, 2014 subpoena to Respondent's sole officer and director via Respondent's purported email address. Respondent's sole officer and director failed to appear for testimony.

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 May 13, 2015, in Hearing Room 2 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.

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74805 / April 24, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16181

In the Matter of **Duncan J. MacDonald, III,** **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") instituted public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Duncan J. MacDonald, III ("Respondent") on September 29, 2014.

II.

In 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 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. MacDonald, 51 years old, is a resident of Dallas, Texas, and is currently imprisoned in Seagoville, Texas. He was the founder and Chairman of the Board of Global Corporate Alliance, Inc. During the relevant period, MacDonald acted as an unregistered broker in violation of Section 15(a) of the Exchange Act.

2. On August 8, 2013, an agreed partial judgment was entered by consent against MacDonald, permanently enjoining him from future violations of Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act"), 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. Duncan J. MacDonald, III, et al., Civil Action Number 3:13-cv-2275, in the United States District Court for the Northern District of Texas.

3. The Commission's complaint alleged that, in connection with the sale of investment contracts, MacDonald directly and indirectly made misrepresentations to investors about the state and success of his business, its history, the use of the investors' funds, and that he otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors. The complaint also alleged that MacDonald, while not registered as a broker or associated with a registered broker, sold unregistered securities.

4. On July 9, 2013, MacDonald pled guilty to one count of conspiracy to commit wire fraud in violation of Title 18 United States Code, Sections 371 and 1343, before the United States District Court for the Northern District of Texas, in United States v. Duncan J. MacDonald, III, No. 3:13-cr-220. On April 3, 2014, a judgment in the criminal case was entered against MacDonald. He was sentenced to a prison term of 60 months followed by three years of supervised release and ordered to make restitution in an amount to be determined, but not less than $ 8.5 million.

5. The counts of the criminal information to which MacDonald pled guilty alleged, inter alia, that MacDonald intentionally defrauded investors and obtained money and property by means of materially false and misleading statements and that he used the interstate wire communications facilities or caused another to use interstate wire communications facilities for the purpose of carrying out the scheme.

IV.

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

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

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

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 9760 / April 24, 2015

Securities Exchange Act of 1934
Release No. 74810 / April 24, 2015

ORDER REGARDING REVIEW OF FASB ACCOUNTING SUPPORT FEE FOR 2015 UNDER SECTION 109 OF THE SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 (the "Act") provides that the Securities and Exchange Commission (the "Commission") may recognize, as generally accepted for purposes of the securities laws, any accounting principles established by a standard setting body that meets certain criteria. Consequently, Section 109 of the Act provides that all of the budget of such a standard setting body shall be payable from an annual accounting support fee assessed and collected against each issuer, as may be necessary or appropriate to pay for the budget and provide for the expenses of the standard setting body, and to provide for an independent, stable source of funding, subject to review by the Commission. Under Section 109(f) of the Act, the amount of fees collected for a fiscal year shall not exceed the "recoverable budget expenses" of the standard setting body. Section 109(h) amends Section 13(b)(2) of the Securities Exchange Act of 1934 to require issuers to pay the allocable share of a reasonable annual accounting support fee or fees, determined in accordance with Section 109 of the Act.

On April 25, 2003, the Commission issued a policy statement concluding that the Financial Accounting Standards Board ("FASB") and its parent organization, the Financial Accounting Foundation ("FAF"), satisfied the criteria for an accounting standard-setting body under the Act, and recognizing the FASB's financial accounting and reporting standards as "generally accepted" under Section 108 of the Act.[1] As a consequence of that recognition, the Commission undertook a review of the FASB's accounting support fee for calendar year 2015. In connection with its review, the Commission also reviewed the budget for the FAF and the FASB for calendar year 2015.

Section 109 of the Act also provides that the standard setting body can have additional sources of revenue for its activities, such as earnings from sales of publications, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual or perceived independence of the standard setter. In this regard, the Commission also considered the interrelation of the operating budgets of the FAF, the FASB, and the Governmental Accounting Standards Board ("GASB"), the FASB's sister organization, which sets accounting standards used by state and local government entities. The Commission has been advised by the FAF that neither the FAF, the FASB, nor the GASB accept contributions from the accounting profession.

The Commission understands that the Office of Management and Budget ("OMB") has determined the FASB's spending of the 2015 accounting support fee is sequestrable under the Budget Control Act of 2011.[2] So long as sequestration is applicable, we anticipate that the FAF will work with the Commission and Commission staff as appropriate regarding its implementation of sequestration.

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[1] Financial Reporting Release No. 70.

[2] See "OMB Report Pursuant to the Sequestration Transparency Act of 2012" (P.L. 112-155), page 222 of 224 at: http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf.

After its review, the Commission determined that the 2015 annual accounting support fee for the FASB is consistent with Section 109 of the Act. Accordingly,

IT IS ORDERED, pursuant to Section 109 of the Act, that the FASB may act in accordance with this determination of the Commission.

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74811 / April 24, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16512

In the Matter of **Frank Perkins Hixon, Jr.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Frank Perkins Hixon, Jr. ("Hixon" 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 contained in Sections III.2. and III.4. below, and 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. Hixon, 56 years old, is a resident of New York, NY. During the relevant period, Hixon worked as an investment banker specializing in the mining, metals, and materials industries. From October 1985 through February 2014, Hixon was also a registered representative associated with broker-dealers registered with the Commission.

2. On April 20, 2015, a judgment was entered by consent against Hixon, permanently enjoining him from future violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5, 14e-3(a), and 14e-3(d) thereunder in the civil action entitled Securities and Exchange Commission v. Frank Perkins Hixon Jr, et al., Civil Action Number 14-cv-0158, in the United States District Court for the Western District of Texas.

3. The Commission's complaint alleged that, in his capacity as an investment banker, Hixon learned material information about companies prior to that information becoming public, including information related to tender offers. After obtaining this material, non-public information, Hixon made, or caused others to make, timely trades in those companies.

4. On April 2, 2014, Hixon pleaded guilty to three counts of securities fraud [18 U.S.C. § 2; 15 U.S.C. §§ 78j(b), 78ff; 17 C.F.R. §§ 240.10b-5, 240.10b5-2], two counts of securities fraud in connection with a tender offer [18 U.S.C. § 2; 15 U.S.C. §§ 78n(e), 78ff; 17 C.F.R. §§ 240.14e-3(a), 240.14e-3(d)], and one count of making a false statement to federal agents [18 U.S.C. § 1001] in *United States v. Frank Perkins Hixon, Jr.*, No. 14-CR-227 (S.D.N.Y.). On August 1, 2014, a judgment in the criminal case was entered against Hixon. He was sentenced to a prison term of 30 months followed by three years of supervised release, fined $100,000, ordered to pay criminal forfeiture of $710,000, and ordered to make restitution of $1,204,777.80 to his former employer. Hixon has paid these amounts in full.

5. The counts of the criminal information to which Hixon pleaded guilty alleged, inter alia, that Hixon (a) used material, non-public information, including information related to tender offers, to trade or cause others to trade in securities; and (b) made false statements to FBI agents during the course of the investigation into his insider trading.

IV.

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

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

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Hixon be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74817 / April 27, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16514

In the Matter of **STEVEN J. MANDERFELD, Esq.,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3)(i)(A) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Steven J. Manderfeld ("Respondent" or "Manderfeld") pursuant to Rule 102(e)(3)(i)(A)[1] of the Commission's Rules of Practice (17 C.F.R. § 200.102(e)(3)(i)(A)).

II.

The Commission finds that:

1. Manderfeld is an attorney licensed in the state of Texas.

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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, temporarily 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 . . . .

2. Between December 2007 and May 2011, Manderfeld, together with his business partners Scott A. Riggs ("Riggs") and C. Darrell Parlee ("Parlee"), raised over $12 million from more than 300 investors nationwide in two fraudulent, unregistered securities offerings. In furtherance of these frauds, Manderfeld served as general counsel to various business entities created and controlled by Riggs, Parlee and Manderfeld, and prepared a Confidential Information Memorandum ("CIM") for each of the fraudulent offerings. The CIMs prepared by Manderfeld contained numerous materially false and misleading statements, including, *inter alia*, false statements about the amount of investor money that would be spent purchasing equipment, the amount of operating profits that would be distributed to investors, and the tax advantages of investing in the offerings.

3. On November 1, 2013, the Commission filed a complaint against Manderfeld and others (Riggs, Parlee, AOS 1-A, LP, AOS 1-B, LP, Ashton Equipment, LLC, and Ashton Oilfield Services, LLC) in the United States District Court for the Northern District of Texas (the "Court"). SEC v. Scott Ashton Riggs, et al., Case Number 3:13-cv-04403-P (N.D. Tex). That complaint charged Manderfeld with violating Sections 5(a), 5(c), and 17(a)(2) of the Securities Act of 1933 ("Securities Act"). As to Manderfeld, the Commission's lawsuit sought a permanent injunction against future violations of the aforementioned sections of the Securities Act, disgorgement of unlawful proceeds with prejudgment interest, and a civil monetary penalty.

4. On April 11, 2014, without admitting or denying the conduct alleged in the complaint, Manderfeld consented to the entry of a judgment that permanently enjoins him from violating Sections 5(a), 5(c), and 17(a)(2) of the Securities Act. On January 27, 2015, the Court entered that injuction and imposed other relief sought in the Commission's lawsuit, including disgorgement in the amount of $12,445,327.33, prejudgment interest in the amount of $1,316,149.17, and a civil penalty in the amount of $150,000.00 (a total of $13,911,476.50).

III.

Based upon the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Manderfeld, an attorney, from violating the Federal securities laws within the meaning of Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice. In view of this finding, the Commission deems it appropriate and in the public interest that Manderfeld be temporarily suspended from appearing or practicing before the Commission as an attorney.

IT IS HEREBY ORDERED that Manderfeld be, and hereby is, temporarily suspended from appearing or practicing before the Commission as an attorney. This Order will be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Manderfeld may, within thirty days after service of this Order, file a petition with the Commission to lift the temporary suspension. If the Commission receives no petition within thirty days after service of the Order, the suspension will become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission will, within thirty days after the filing of the petition, either lift the temporary suspension, or sschedule the matter for a hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure Manderfeld, or disqualify Manderfeld from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Manderfeld personally or by certified mail at his last known address.

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74815 / April 27, 2015

WHISTLEBLOWER AWARD PROCEEDING
File No. 2015-3

In the Matter of the Claims for
Awards in connection with:

SEC v. Citigroup Inc., Civil Action No. 1:10-CV-01277
Notice of Covered Action 2011-33

In the Matter of Merrill Lynch, Pierce, Fenner & Smith Incorporated, Administrative Proceeding File No. 3-14204
Notice of Covered Action 2011-101

In the Matter of Navistar International Corporation, Daniel C. Ustian, Robert C. Lannert, Thomas M. Akers, Jr., James W. McIntosh, James J. Stanaway, Ernest A. Stinsa, Michael J. Schultz, Administrative Proceeding File No. 3-13994
Notice of Covered Action 2011-110

In the Matter of Wells Fargo Securities LLC (f/k/a Wachovia Capital Markets LLC), Administrative Proceeding File No. 3-14320
Notice of Covered Action 2011-162

In the Matter of Morgan Stanley Investment Management Inc., Administrative Proceeding File No. 3-14628
Notice of Covered Action 2011-211

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

Claimant ("Claimant") filed timely whistleblower award applications pursuant to Section 21F of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78u-6, in connection with the five Notices of Covered Actions ("NoCA") listed above. The Claims Review Staff ("CRS") subsequently issued a Preliminary Determination recommending that Claimant's applications be denied. After carefully reviewing Claimant's timely response contesting the Preliminary Determination along with the rest of the record, we have determined to deny Claimant's applications.

To qualify for an award under Section 21F, a whistleblower must voluntarily provide the Commission with original information that leads to the successful enforcement of a covered judicial or administrative action. 15 U.S.C. § 78u-6(b)(1).[1] With respect to four of the five Covered Actions, the record conclusively demonstrates that Claimant submitted [redacted] tip *after* those matters were settled. For that reason, we find that the tip could not have led to the successful enforcement of those four Covered Actions.

With respect to the fifth Covered Action, *In the Matter of Morgan Stanley Investment Management Inc.* (NoCA 2011-211) ("*Morgan Stanley*"), we also find that Claimant's tip did not lead to the successful enforcement of the matter. The record demonstrates that, after Claimant submitted [redacted] tip, the office within the Enforcement Division that is responsible for undertaking a preliminary review of whistleblower tips designated the tip for "no further action" and did not forward it to any of the staff members assigned to *Morgan Stanley*. Further, there is no indication in the record that the Enforcement staff members responsible for *Morgan Stanley* either received or relied upon any information provided by Claimant, and Claimant has not shown otherwise in [redacted] request for reconsideration of the Preliminary Determination.[2]

Accordingly, it is ORDERED that Claimant's whistleblower award applications be, and hereby are, denied.

By the Commission.

Brent J. Fields
Secretary

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[1] As relevant here, a whistleblower tip "leads to" a successful enforcement action if either: (i) the tip caused the staff to open an investigation, reopen an investigation, or inquire into different conduct as part of a current examination or investigation, and the Commission brought a successful action based in whole or in part on conduct that was the subject of the original information; or (ii) the conduct was already under examination or investigation, and the tip significantly contributed to the success of the action. Rules 21F-4(c)(1) and 21F-4(c)(2), 17 C.F.R. § 240.21F-4(c)(1) and 17 C.F.R. §240.21F-4(c)(2).

[2] Although not the basis for our decision, we note that the information provided by Claimant likely would not qualify as original information as defined in Rule 21F-4(b)(1) of the Exchange Act because it appears that the information was largely copied from a third party's publicly-available court filings.

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74816 / April 27, 2015

ACCOUNTING AND AUDITING ENFORCEMENT ACT
Release No. 3652 / April 27, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16513

In the Matter of Donald J. Torbert, CPA, and Nicole S. Stokes, CPA, Respondents.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Donald J. Torbert and Nicole S. Stokes (collectively "Respondents").

II.

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

III.

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

Summary

1. This matter involves the role of Donald J. Torbert ("Torbert") and Nicole S. Stokes ("Stokes") in violations of the reporting, books and records, internal controls and certification provisions relating to The Park Avenue Bank (the "Bank"), the wholly-owned subsidiary of PAB Bankshares, Inc. ("PAB" or the "Company"), during the period ended June 30, 2009. The violations resulted from the Bank understating its loan losses for three large loans that quarter, and as a result reporting positive net income of $342,000, despite reporting quarterly losses since September 30, 2008. Had PAB properly recognized loan losses for any of the three loans, it would have continued to report losses.

2. As a result of this conduct, PAB violated the reporting, books and records and internal control provisions of the Exchange Act. Torbert, the Bank's former Chief Executive Officer, and Stokes, the former Chief Financial Officer, each caused these violations and in addition, Torbert and Stokes violated the Exchange Act's certification requirements relating to PAB's Form 10-Q for the second quarter 2009.

Respondents

3. **Donald J. ("Jay") Torbert, Jr.,** age 42, is a resident of St. Simons Island, Georgia. During the relevant period, he was President and Chief Executive Officer of PAB and the Bank, a position he held from April 2009 until the Bank was closed in April 2011. He previously served as Executive Vice President, Chief Financial Officer and Treasurer of the Company and the Bank from August 2001 to April 2009. Torbert is a certified public accountant licensed in Georgia.

4. **Nicole S. Stokes,** age 40, is a resident of Valdosta, Georgia. During the relevant period, Stokes was PAB and the Bank's Senior Vice President and Controller from December 2005 to April 2009 and PAB and the Bank's Senior Vice President and Chief Financial Officer from April 2009 to October 2010. From October 2009 to December 2010, Stokes served as Executive Vice President and Chief Financial Officer. Stokes is a certified public accountant licensed in Georgia.

Relevant Entity

5. **PAB Bankshares, Inc.**, was a bank holding company, organized and incorporated in 1982 under the laws of the State of Georgia as the bank holding company for The Park Avenue Bank, headquartered in Valdosta, Georgia. Prior to its ceasing operations, PAB operated thirteen branches located in seven counties in South Georgia; four branches and one loan production office located in four counties in North Georgia; and one branch and one loan production office located in two counties in Florida. The bank holding company's stock was

registered with the Commission pursuant to Section 12(b) of the Exchange Act and its shares traded on the NASDAQ Global Select Market.

FACTS

A. Background

6. Until April 2011, when it was closed by the FDIC, the Bank, which was the wholly-owned subsidiary of PAB, a publicly held bank holding company, had operations centered in Georgia and Florida. In PAB's Form 10-Q for the quarter ended September 30, 2010 (the Bank's last periodic filing that included financial statements), PAB reported total assets of approximately $1.0 billion.

7. In 2000, PAB began to expand its loans for the construction and development of real estate. Between December 2004 and December 2007, construction and development loans increased from 26% of the Bank's loan portfolio to 38%. When the financial crisis occurred in 2008, this area of the real estate market was hit particularly hard, and PAB's non-performing construction and development loans began to rise steadily. By late 2008, PAB was reporting quarterly net losses, a trend that continued through the quarter ended September 30, 2010, except for the quarter ended June 30, 2009, when it reported a net income of $342,000.

For the quarter-ended: (in thousands of dollars, except for earnings per share amounts)							
	6/30/08	9/30/08	12/31/08	3/31/09	6/30/09	9/30/09	12/31/09
Net income/ (loss)	$1,463	($2,860)	($5,811)	($295)	$342	(19,956)	(31,262)
EPS	$0.15	($.32)	($0.60)	($0.03)	$0.04	($1.93)	($2.27)

8. In early 2009, PAB commenced a private placement of its common stock and disclosed that it would use the capital raise to bolster capital to absorb future non-performance and to increase its capital position. The private placement closed in the third quarter of 2009 and raised $13,412,000 from Bank officers and directors and their families and one institutional investor. The additional capital generated by the private placement subsequently offset reductions in PAB's capital levels caused primarily by the increase in PAB's loan loss allowance for that quarter.

9. PAB's loan portfolio continued to deteriorate throughout 2010, and on April 29, 2011, PAB's bank regulators closed the Bank.

B. PAB Reports Earnings in the Second Quarter 2009

10. During the second quarter 2009, PAB was continuing to grapple with a loan portfolio in quick decline. Many of the Bank's construction and development loans were collateral dependent, so as a borrower began to experience problems paying the loan, the collateral underlying the loan often had lost value as well, leading the loans in many cases to become impaired. 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.

11. When a loan becomes impaired, the amount of impairment is measured and recorded as an allowance for estimated losses on the loan. Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan, allows impairment to be

measured based on the fair value of underlying collateral if a loan is collateral dependent; and when the creditor determines that foreclosure is probable, it is required that measurement for impairment be based on the fair value of the collateral. Statement of Financial Accounting Standards No. 157, Fair Value Measurements, requires that the assumptions used to determine the collateral's fair value be based on those that would be used by a market participant to determine the price to be paid in an orderly transaction at the measurement date.

12. Thus, when PAB determined a loan was impaired, its policy was to assess the fair value of the collateral to calculate the appropriate amount of the loan loss allowance. Additionally, PAB assessed whether loan losses included in the allowance should be charged off. As reflected in its disclosures, the Bank typically measured fair value by independent appraisals of the collateral.

13. In certain cases where the Bank determined the borrower was unable to continue with any amount of payment, it would foreclose on the loan and the collateral would become the Bank's own real estate, known as Other Real Estate Owned ("OREO"). When loans are foreclosed upon, the collateral received is recognized based on its fair value and any difference between the recorded amount of the loan and the collateral recognized is charged off. Prior to foreclosure, Generally Accepted Accounting Principles ("GAAP") required PAB to charge off the loan in the period in which the loan was deemed uncollectible.

14. PAB employed an in-house appraiser, whose role was to review independent third party appraisals received by the Bank for reasonableness, and in other circumstances, to provide his own valuation of collateral properties associated with impaired loans. PAB occasionally received appraisals from third parties where it disagreed with the valuation, and thus requested the in-house appraiser to recalculate valuations based on his own discounted cash flow analysis.

15. In the second quarter of 2009, the Bank acted unreasonably in determining the amount by which it was required to recognize estimated losses for one large loan that had been foreclosed upon and two large impaired collateral dependent loans. In each of these instances, the Bank substituted its own valuation analysis for that of an independent third party, and in doing so, did not reasonably estimate the market participant view of the fair value of the collateral. Because each of these instances resulted in PAB measuring impairment based on a value for the loan's underlying collateral that was greater than a fair value estimate consistent with GAAP, PAB recognized a lower loss on each of these assets in the second quarter of 2009. Had the Bank properly accounted for the assets, additional charges would have resulted in a net loss for the quarter instead of the positive recorded net income. In addition, any one of these over-valuations were individually material to PAB's financial statements for that quarter.

C. PAB Failed to Charge Off the Proper Amount for the Grove Village Loan

16. In 2005, PAB made a loan to Grove Village LLC for construction and development of 250 single-family residential lots. As of mid-2008, the outstanding principal on the loan was $9 million, and the loan had several pieces of collateral by which it was secured, including the undeveloped lots.

17. By April 2009, the borrower was no longer able to make payments on the loan, leading it to become impaired. The loan was considered collateral dependent because there were no other sources of available cash flows. An independent appraisal received by PAB in April 2009 valued the lots at $4.2 million, using a discount rate of 14% and an absorption rate of seven years. In June 2009, the bank foreclosed on the development. After receiving the April appraisal, a bank employee sent an email to the Bank's Chief Credit Officer ("CCO") and to

Stokes, in which the loan officer estimated an additional charge-off of $1.1 million on the loan and asked whether this new appraisal value should be used.

18. The CCO responded, copying Torbert, that Torbert was concerned about the charge off. Further in the email discussion, Torbert wrote that he was not comfortable taking a loss of this size based on one appraisal and that the property should be valued from an investment hold perspective rather than a liquidation perspective.

19. Torbert then asked PAB's in-house appraiser for his opinion on the discount and absorption rates used by the independent appraiser. The in-house appraiser responded that the current market was saturated, making discount and absorption rates high.

20. Torbert replied that he did not agree with these rates, "It may be the market, but I think a 14% discount rate is a bit steep . . . . We have to look at it as a long-term investor, but I think we would be fine to accept a much lower discount rate than a 3rd party investor." Torbert asked the in-house appraiser to re-run the numbers with a 4-5 year absorption rate and a discount rate of 9-10%. The appraiser complied and prepared a discounted cash flow analysis using a 9% discount rate and a 5-year absorption rate. The resulting new fair value of $5.4 million was adopted by PAB as the current value of the collateral when the lots were booked into OREO in June 2009.

21. PAB acted unreasonably in substituting management's valuation of the collateral for that of a current market participant view, as reflected in the independent third party appraisal. PAB was valuing the property based on its own expectations of the property's value as a long term investment, not with reference to the current market or market participant assumptions, as GAAP requires.

22. Had PAB used the independently appraised value for the 250 lots available as of April 2009, the loss recognized on this loan would have increased by $1.2 million in the second quarter 2009. The OREO was ultimately charged off down to the independent appraisal value of $4.2 million in December 2010.

23. Torbert directed the in-house appraiser to substitute the discount and absorption rates on this loan. Stokes was copied on the email exchange between Torbert and PAB's in-house appraiser about this loan. Thus, both Torbert and Stokes knew or should have known that the collateral was not being valued in accordance with GAAP.

D. PAB Failed to Adequately Reserve for the Mitchell Building Loan

24. In 2005, PAB made a $3.5 million loan to Mitchell Building LLC to develop 74 single-family residential subdivision lots. The development was originally appraised at $4.8 million in 2005. In December 2007, the borrower informed PAB that it could no longer make payments on the loan. In February 2008, PAB entered into the first of four successive 90-day forbearance agreements to provide the borrower with more time to complete the project.

25. From inception, the development was plagued with zoning issues. The number of lots available for development continued to decrease, from the initial 74 lots, to 64 lots by the end of the first quarter 2009, to 60 lots by the end of the second quarter 2009. During the first quarter 2009, a local developer made a verbal offer for the purchase of 10 lots at $32,000 each, with future lot purchases to be negotiated at a later date.

26. By the second quarter 2009, the borrower was no longer involved in the project and PAB had assumed responsibility for completing the subdivision with the Bank's own funds.[1] At this point, although still in negotiations, no definitive agreement had been reached between the Bank and the local developer, in part due to the ongoing zoning issues.[2]

27. In early May 2009, a new appraisal was completed on this subdivision, which appraised the now-60 lots at $1.3 million "as is." The appraisal was dated May 10, 2009 and the invoice provided to PAB was dated May 18, 2009.

28. In early June, an addendum to the appraisal was prepared, taking into consideration the proposed sale of 10 lots for a contract price of $32,000 per lot, and using a 13% discount rate and a 3.75 year absorption rate. The appraisal addendum increased the value of the collateral to $1,350,000.

29. PAB's in-house appraiser reviewed the May 2009 appraisal and addendum on July 8, 2009. On July 9, 2009, he prepared his own discounted cash flow of the collateral valuation, using a 9% discount rate and a 3.75 year absorption rate based on the same $32,000 per lot sale price for an estimated value of $1,890,000.

30. In calculating the allowance for this impaired loan at June 30, 2009, however, PAB gave no consideration to the May 2009 appraisal, the June 2009 addendum or its own in-house appraiser's July 9, 2009 discounted cash flow. In part, due to lax internal controls, as discussed below, this was because PAB personnel preparing the allowance calculations were not aware of the May/June appraisals or the in-house appraiser's assessment. Instead, using the original 2005 appraisal, discounted by 15% for the deteriorating market and 6% for estimated selling costs, PAB valued the collateral at June 30, 2009 at $3.1 million.

31. Because this appraisal was over four years old, and PAB had current appraisals available to it at the time with more current assessments of market value, it was unreasonable to rely on the 2005 appraisal in determining allowance amounts for this loan.

32. In addition, in determining the allowance amount, PAB personnel relied on documentation provided by the credit department, including a Criticized/Classified Loan Status Report ("Criticized/Classified Report") dated March 31, 2009 and prepared on April 22, 2009 by the PAB loan officer responsible for the loan. In that report, the loan officer noted that the Bank was waiting on a new appraisal of the collateral.

33. At the time, it was the Bank's practice to rely on Criticized/Classified Reports from the prior quarter-end to calculate the current quarter-end loan loss allowance. Due to the rapid pace at which economic conditions were deteriorating in this market at the time, this reliance on untimely information was unreasonable.

34. Had PAB used the May 2009 appraisals, or its own in-house discounted cash flow analysis, the specific reserve for the Mitchell Building loan would have increased by at least $1.2

[1] Had PAB determined to charge off this loan in the second quarter instead of continuing to reserve for it, the impact on the balance sheet and the income statement effectively would have been the same, as either application required the loan be reduced or reserved for as an amount reflecting the fair value of the collateral, and any difference between the current fair value and the existing book balance less existing allowances would be recognized as a charge to earnings.

[2] The local developer ultimately walked away from the project, and it was not completed by the time the Bank was closed.

million and as much as $1.9 million in the second quarter 2009. During the following quarter, the Bank determined the allowance amount on this loan by using the in-house appraiser's discounted cash flow prepared in July 2009, resulting in an addition of $1.2 million to its loan loss allowance. In December 2009, PAB charged off the loan down to the $1.3 million based on the May 2009 appraisal.

35. Stokes prepared and Torbert signed the June 2009 allowance amounts for this loan, and in doing so, they reviewed or should have reviewed the March 31, 2009 Criticized/Classified Report, which noted in capital letters that a new appraisal was pending. In fact, the new appraisal had been completed by the end of the second quarter 2009, and had been reviewed by at least one Bank employee.

36. Stokes and Torbert also knew or should have known that the Criticized/Classified Report was based on information from the previous quarter, and that it was unreasonable to continue to base a valuation on a 2005 appraisal when an updated appraisal had been received.

E. PAB Failed to Adequately Reserve for the <u>R&B Construction of Northwest Florida Loan</u>

37. R&B Construction was a starter-home builder in the south metro markets of Atlanta that had expanded into northwestern Florida with plans to build homes in that market for Eglin Air Force base.

38. In October 2008, with a loan balance of $6.1 million, PAB received an independent appraisal that valued the Florida property at $3.3 million. In determining a value for the collateral, the appraiser considered the impact of a potential increase in Air Force personnel in the area. But at year-end 2008, PAB recorded a loan charge-off of $1.6 million to reduce the loan to $4.5 million. This valuation of the collateral was determined by the in-house appraiser and based on his own predictions of future increases in property values due to the proposed upcoming transfer of military personnel.

39. In April 2009, a third-party loan review firm, which had been retained to conduct a special review of loans as part of the capital raise efforts, reviewed this loan and disagreed with the in-house valuation. Instead, the third-party reviewer recommended use of the October 2008 appraisal to determine the loan loss allowance, stating that it was reflective of the current market value, and that the in-house assessment based in part on an assumed large increase in housing demand due to upcoming transfer of military personnel was not consistent with a market participant view. Both Torbert and Stokes received the third party loan review firm's recommendation.

40. In late June 2009, an internal email circulated noting that the foreclosure hearing on the property would be held in July. Torbert and Stokes were both copied on the email and thus were aware that foreclosure on this loan was probable. In subsequent emails that did not copy Torbert and Stokes, the loan officer responsible for this loan and the Chief Credit Officer discussed whether the amount for which the Bank would be willing to sell the property should be slightly below the October 2008 $3.3 million appraisal value and related charge-offs. The Chief Credit Officer said they should check with Torbert and Stokes. At this point both Torbert and Stokes knew or should have known that the October appraised value was being considered as an estimate of the fair value of the property.

41. Stokes was also aware by July 21 that the foreclosure had been finalized at a court hearing and as a result on July 20, 2009, the PAB loan officer responsible for the loan prepared

the paperwork to transfer this loan into OREO and recorded the OREO at a fair value of $3.3 million. PAB filed its Form 10-Q for the quarter on August 10, 2009. Torbert learned of these facts on August 17, 2009.

42. When evaluating this loan for the quarter-ended June 30, 2009 financial statements, however, PAB did not appropriately account for the loan loss allowance using the October 2008 appraised value of $3.3 million, which reflected a fair value estimate based on market participant assumptions. Instead, the Bank continued to take an allowance on the loan based on its previous in-house valuation of $4.5 million, which was based on stale assumptions that were inconsistent with market participant assumptions at the measurement date.

43. Had PAB used the October 2008 appraisal valuation and recognized the resulting additional loan loss for this loan at the end of the second quarter 2009, an additional loss of $1.1 million would have been recorded. The loan amount was ultimately foreclosed on in the third quarter 2009 and the fair value of the OREO property was recognized at $3.3 million. Stokes prepared and Torbert approved the allowance calculations for this loan for the quarter ending June 2009. In doing so, they were or should have been aware that this collateral had a fair value of $3.3 million and should have recognized a loan loss allowance based on the $3.3 million fair value.

44. As CEO and CFO, Torbert and Stokes both signed and certified the Form 10-Q filed with the Commission for the quarter ended June 30, 2009.

Violations

45. Section 13(a) of the Exchange Act and Exchange Act Rule 13a-13 require issuers of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission accurate periodic reports, including quarterly reports on Form 10-Q. Rule 12b-20 further requires that the required reports must contain any material information necessary to make the required statements made in the reports not misleading. As a result of the conduct described above, PAB violated and Torbert and Stokes caused violations of these provisions by PAB.

46. 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. As a result of the conduct described above, PAB violated and Torbert and Stokes caused violations of these provisions by PAB.

47. Section 13(b)(2)(B) requires issuers of securities registered pursuant to Section 12 of the Exchange Act 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. As a result of the conduct described above, PAB violated and Torbert and Stokes caused violations of Section 13(b)(2)(B) of the Exchange Act by PAB.

48. As a result of the conduct described above, Torbert and Stokes violated Rule 13a-14 under the Exchange Act, which sets forth the requirements for certain reports filed under Section 13(a) of the Exchange Act to include specified certifications by each principal executive and principal financial officer of the issuer.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Torbert's and Stokes's Offers.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondents Torbert and Stokes cease and desist from committing or causing any violations and any future violations of Section 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-13 and 13a-14 thereunder.

B. Respondent Torbert shall pay a civil penalty of $40,000, and Respondent Stokes shall pay a civil penalty of $20,000, to the Securities and Exchange Commission. Payment shall be made in the following installments: Torbert shall pay $10,000 within 30 days of the entry of this Order, and the remaining $30,000 within 364 days of the entry of this Order. Stokes shall pay $5,000 within 30 days of the entry of this Order, and the remaining $15,000 within 364 days of the entry of this Order. Payment shall be made to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. Section 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 Torbert and Stokes as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Laura B. Josephs, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

C. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, 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 Respondents, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondents 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 Respondents 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.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 74826 / April 28, 2015

WHISTLEBLOWER AWARD PROCEEDING

File No. 2015-4

In the Matter of the Claim for Award

in connection with

In the Matter of Paradigm Capital Management, Inc. and Candace King Weir, File No. 3-15930 (June 16, 2014)
Notice of Covered Action 2014-71

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

On March 9, 2015, the Claims Review Staff issued a Preliminary Determination related to Notice of Covered Action 2014-71 (the "Covered Action"). The Preliminary Determination recommended that Claimant receive a whistleblower award because *** 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, of the monetary sanctions collected or to be collected in the Covered Action, which will be over $600,000. 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 application. In particular, the Claims Review Staff considered the substantial evidence that the whistleblower suffered unique hardships as a result of reporting, and also found the Commission's law enforcement interest to be compelling given the Commission's previous findings of unlawful retaliation against this whistleblower. *See* Rule 21F-6(a)(2)(vi) and (a)(3), 17 C.F.R. § 240.21F-6(a)(2)(vi) and (a)(3).

On March 9, 2015, Claimant provided written notice to the Commission of *** decision 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 Rules 21F-10(f) and (h), 17 C.F.R. § 240.21F-10(f) and (h), and for the reasons set forth in the Preliminary Determination, it is hereby ORDERED that Claimant shall receive an award of thirty percent (30%) of the monetary sanctions collected in this Covered Action, including any monetary sanctions collected after the date of this Order.

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74820 / April 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16516

In the Matter of **Greenbridge Technology, Inc.,** **Harrods Investments, Inc.,** **Illusion Digital Systems, Inc., and** **International Builders Ltd., Inc. (f/k/a Ocean Fresh Seafood Marketplace, 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 Greenbridge Technology, Inc., Harrods Investments, Inc., Illusion Digital Systems, Inc., and International Builders Ltd., Inc. (f/k/a Ocean Fresh Seafood Marketplace, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Greenbridge Technology, Inc. (CIK No. 1437236) is a void Delaware corporation located in Newport Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Greenbridge is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $5,000 from the company's May 16, 2008 inception to September 30, 2008.

2. Harrods Investments, Inc. (CIK No. 1140297) is a permanently revoked Nevada corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Harrods 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, 2002, which reported a net loss of $5,778 for the prior nine months.

3. Illusion Digital Systems, Inc. (CIK No. 1392544) is a delinquent Colorado corporation located in Beverly Hills, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Illusion Digital is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2008, which reported a net loss of $6,500 from the company's February 16, 2007 inception to December 31, 2008.

4. International Builders Ltd., Inc. (f/k/a Ocean Fresh Seafood Marketplace, Inc.) (CIK No. 1126579) is a revoked Florida corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). International Builders is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2004, which reported a net loss of $134,782 for the prior three months.

B. DELINQUENT PERIODIC FILINGS

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

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

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.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74819 / April 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16515

In the Matter of Jesters Resources, Inc., Jet Neko, Inc., and Kensington 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 Jesters Resources, Inc., Jet Neko, Inc., and Kensington Group, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Jesters Resources, Inc. (CIK No. 1413661) is a revoked Nevada corporation located in Shanghai, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Jesters is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended April 30, 2009, which reported a net loss of $14,920 for the prior nine months.

2. Jet Neko, Inc. (CIK No. 1541371) is a void Delaware corporation located in Miyazaki, Japan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Jet Neko is delinquent in its periodic filings with the

Commission, having not filed any periodic reports since it filed a Form 10 registration statement on February 9, 2012. As of April 9, 2015, the company's stock (symbol "NEKO") was quoted on OTC Link (previously, "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).

3. Kensington Group, Inc. (CIK No. 1350113) is a void Delaware corporation located in Shenzhen, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Kensington is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on February 6, 2006, which reported a net loss of $4,000 from the company's December 8, 2005 inception to December 31, 2005.

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.

Brent J. Fields
Secretary

Commissioner Gallagher Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74827 / April 29, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4072 / April 29, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31585 / April 29, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3654 / April 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16519

In the Matter of SIMON LESSER, CPA, CA Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, SECTION 9(b) OF THE INVESTMENT COMPANY ACT, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to pursuant to Section 4C[1] of the Securities Exchange Act of 1934 ("Exchange

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

Act"), Sections 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) of the Commission's Rules of Practice[2] against Simon Lesser ("Lesser" 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, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934, Section 203(k) of the Investment Advisers Act of 1940, Section 9(b) of the Investment Company Act of 1940, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

A. SUMMARY

1. Over a period of four years, Simon Lesser, an audit partner at McGladrey LLP ("McGladrey"), approved McGladrey's issuance of audit reports containing unqualified opinions that financial statements for several private funds were presented fairly in conformity with Generally Accepted Accounting Principles ("GAAP") even though the financial statements did not adequately disclose related party relationships or material related party transactions. In particular, the investment adviser to the private funds used fund assets to pay its own adviser-related operating expenses, transferring $3,452,353 from the funds over the course of four years. These material related party transactions involved related party relationships that GAAP requires be disclosed in financial statements. Despite that requirement, the relationships and transactions were not disclosed in the private funds' financial statements. Lesser knew about the related party relationships and transactions, but nevertheless gave his final approval for McGladrey to issue audit reports

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The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . to have engaged in ... improper professional conduct.

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

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

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

containing unqualified opinions that the private funds' financial statements were presented fairly in conformity with GAAP. The adviser then provided the audited financial statements to the private funds' investors in order to comply with the custody rule under the Advisers Act. Further, in conducting his audit work, Lesser failed to conduct the audits in accordance with many Generally Accepted Auditing Standards ("GAAS"), including failing to have adequate professional skepticism, failing to supervise the audit and failing to adequately document McGladrey's audit work. As a result, Lesser aided and abetted and caused the adviser's violations of the Advisers Act's custody rule and engaged in improper professional conduct within the meaning of Rule 102(e) of the Commission's Rules of Practice.

B. RESPONDENT

2. **Simon Lesser, CPA, CA** ("Lesser"), age 58, resides in Wilmette, Illinois. Lesser is currently a partner at McGladrey, a PCAOB-registered accounting firm, and has worked for McGladrey since 2005. He is a certified public accountant licensed in Illinois and a chartered accountant in England and Wales. At McGladrey, Lesser specializes in audits of entities within the financial services industry, and the majority of his McGladrey clients are private funds.

C. OTHER RELEVANT ENTITIES AND INDIVIDUAL

3. **Alpha Titans LLC** ("Alpha Titans") is a California limited liability company based in Santa Barbara, California. It has been registered with the Commission as an investment adviser since 2007. As a registered investment adviser, Alpha Titans is subject to the custody rule promulgated under Section 206(4) of the Advisers Act and set forth as Rule 206(4)-2 thereunder. Alpha Titans elected to comply with the custody rule by distributing to the private funds' investors annual audited financial statements prepared in accordance with GAAP, and audited by an independent public accountant registered with, and subject to regular inspection by, the PCAOB, within 120 days of the end of the fiscal year. Alpha Titans did not submit to surprise examinations.

4. **Alpha Titans LP**, a Delaware limited partnership, is an onshore hedge fund formed by Alpha Titans' principal in September 2007; Alpha Titans is the general partner. **Alpha Titans, Ltd.** (collectively with Alpha Titans LP, the "Feeder Funds"), a Cayman Islands exempted company, is an offshore hedge fund formed by Alpha Titans' principal in October 2007 and managed by Alpha Titans.

5. **Alpha Titans MF SPC** (the "Master Fund"), a Cayman Islands segregated portfolio company, is a hedge fund formed by Alpha Titans' principal in October 2007. Alpha Titans pools together assets from the Feeder Funds to invest in the Master Fund. Alpha Titans and Alpha Titans' principal control these funds.

6. **Montreux Partners SPC** ("Montreux"), a Cayman Islands exempted segregated portfolio company, and **Trading Solutions Ltd.** ("Trading Solutions"), a Cayman Islands exempted company, are operated by Alpha Titans' principal as special purpose vehicles for use with the Master Fund's investments. Alpha Titans' principal also uses Montreux to pay Alpha Titans' adviser-related operating expenses. Alpha Titans' principal formed Montreux and Trading Solutions in February 2008 and June 2009, respectively, and he controls both entities.

D. FACTS

Background

7. Alpha Titans' principal controls Alpha Titans, the Feeder Funds, the Master Fund, Trading Solutions and Montreux. Limited partners and shareholders invested money in the Feeder Funds. That money then flowed to the Master Fund. The Master Fund purchased equity options from Trading Solutions. Trading Solutions invested that money in Montreux. Ultimately, Montreux used the Feeder Funds' money to invest in unrelated private funds.

8. From August 2009 through 2012, the Master Fund and Montreux used investor money to pay Alpha Titans' operating expenses. In particular, from August 2009 through 2012, the Master Fund paid $2,004,576 of Alpha Titans' employee salaries and health benefits. Similarly, from October 2009 through 2012, Montreux paid $1,447,777 of Alpha Titans' operating expenses, including monthly office rent and parking, utility and phone bills, credit card bills, employee salaries and benefits, and other adviser-related operating expenses.

Alpha Titans Did Not Prepare the Feeder Funds' and the Master Fund's Financial Statements in Accordance with GAAP, Which Led Alpha Titans to Violate the Custody Rule

9. Alpha Titans engaged McGladrey as the Feeder Funds' and the Master Fund's independent public accountant to audit their financial statements for the fiscal years ended December 31, 2009, 2010, 2011, and 2012. To comply with the custody rule, Alpha Titans apparently intended to provide the Feeder Funds' limited partners and shareholders with GAAP-compliant financial statements of the Feeder Fund and the Master Fund, pursuant to the custody rule exception found in Advisers Act Rule 206(4)-2(b)(4).

10. GAAP provides disclosure requirements for related party relationships and transactions in financial statements. (*See*, *generally*, Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 850-10-50) Alpha Titans, the Feeder Funds, the Master Fund, Montreux and Trading Solutions were related parties because Alpha Titans' principal had common control over each entity since Alpha Titans' principal formed and directed all investment activities and operating policies of each entity. (ASC 850-10-20, *et seq.*) This common control allowed Alpha Titans' principal to pay Alpha Titans' adviser-related operational expenses, including employee salaries and related expenses, using money held by Montreux and the Master Fund. This led to operating results of the Feeder Funds and the Master Fund that could have been "significantly different" from those that would have been obtained if Alpha Titans' principal did not have the control and ability to cause these entities to pay Alpha Titans' adviser-related operating expenses. (ASC 850-10-50-6) The Master Fund's and Montreux's payments of Alpha Titans' adviser-related operating expenses were material related party transactions in fiscal years 2009 through 2012.

11. The Feeder Funds' and the Master Fund's audited financial statements for fiscal years 2009 through 2012 were not in compliance with GAAP. In particular, the Feeder Funds' and the Master Fund's audited financial statements for fiscal years 2009 through 2012 did not disclose (i) the related party relationships among Alpha Titans, the Feeder Funds, the Master Fund, Trading Solutions and Montreux, and Alpha Titans' principal's common control of these

entities, and (ii) the material related party transactions concerning the Master Fund's and Montreux's payments of Alpha Titans' adviser-related operating expenses.

12. Neither the Feeder Funds' nor the Master Fund's 2009 financial statements disclosed (i) the related party relationships, (ii) that Montreux paid $208,712 of related party expenses, and (iii) that $287,420 of the Master Fund's operating expenses were related party transactions. The 2009 financial statements for the Feeder Funds included a note disclosing (collectively) only $318 of related party transactions and did not make any disclosure as to the related party relationships. Further, the Master Fund financial statements included operating expenses totaling $319,823, but did not disclose that $287,420 (or 90%) was attributable to Alpha Titans' employee payroll and benefits, which were related party transactions. Rather, the notes to the financial statements disclosed only $1,226 in related party transactions and did not describe the related party relationships.

13. Neither the Feeder Funds' nor the Master Fund's 2010 financial statements disclosed (i) the related party relationships, (ii) that Montreux paid $361,429 of related party expenses, and (iii) that all of the Master Fund's operating expenses were related party transactions. Instead, the 2010 financial statements for the Feeder Funds included a note indicating there were no related party transactions. For example, in Alpha Titans LP's 2010 financial statements, the note provided "Pursuant to the terms of the Fund's limited partnership agreement, the General Partner is able to pay expenses on behalf of the Fund and subsequently be reimbursed for actual overhead costs and expenses that are directly connected with the management and operations of the Fund. For the year ended December 31, 2010, there was no reimbursement." The Master Fund's financial statements included operating expenses totaling $634,895, but did not disclose that 100% of it was attributable to Alpha Titans' employee payroll and benefits, which were related party transactions. Rather, the notes to the financial statements disclosed only $1,043 in related party transactions and did not explain the related party relationships.

14. Neither the Feeder Funds' nor the Master Fund's 2011 financial statements disclosed (i) the related party relationships, (ii) that Montreux paid $537,999 of related party expenses, and (iii) that $614,995 of the Master Fund's operating expenses were related party transactions. Instead, the 2011 financial statements for the Feeder Funds and the Master Fund included a note indicating there were no related party transactions. For example, in Alpha Titans LP's 2011 financial statements, the note provided "Pursuant to the terms of the Fund's limited partnership agreement, the General Partner is able to pay expenses on behalf of the Fund and subsequently be reimbursed for actual overhead costs and expenses that are directly connected with the management and operations of the Fund. For the year ended December 31, 2011, there was no reimbursement." The Master Fund's financial statements included operating expenses totaling $700,736, but did not disclose that $614,995 (or 88%) was attributable to Alpha Titans' employee payroll, benefits, and other employee payments, which were related party transactions.

15. Neither the Feeder Funds' nor the Master Fund's 2012 financial statements disclosed (i) all the related party relationships, and (ii) that Montreux paid $339,639 of related party expenses. Instead, the 2012 financial statements for the Feeder Funds included a note indicating there were no related party transactions. For example, in Alpha Titans LP's 2012 financial statements, the note provided "Pursuant to the terms of the Fund's limited partnership

agreement, the General Partner is able to pay expenses on behalf of the Fund and subsequently be reimbursed for actual overhead costs and expenses that are directly connected with the management and operations of the Fund. For the year ended December 31, 2012, there was no reimbursement." The Master Fund's financial statements included operating expenses totaling $781,732. Unlike previous years, the notes to the financial statements provided some additional detail, explaining that "During 2012, employees of the Investment Manager did provide services to the Company in the amount of $467,267 and were paid by the Company."

16. Overall, from 2009 through 2012, Montreux paid a total of $1,447,777 in related party transactions that were not disclosed in the Feeder Funds' or the Master Fund's financial statements. In addition, from 2009 through 2011, the Master Fund paid a total of $1,537,309 of Alpha Titans' employee payroll, benefits and other employee payments that were not identified as related party transactions in the notes to the financial statements, but instead were listed simply as "operating expenses" on the income statement for the Master Fund.

17. For the 2009 through 2012 fiscal year-ends, McGladrey's audit reports stated that it audited the Feeder Funds' and the Master Fund's financial statements in accordance with GAAS, and included unqualified opinions for each entity, in each year, that the financial statements were presented fairly in conformity with GAAP.

18. Lesser served as the lead engagement partner for the fiscal year-end 2009 through 2012 financial statement audits of the Feeder Funds and the Master Fund. Lesser was responsible for the audit engagement and its performance and for the audit report issued on behalf of McGladrey.

19. Lesser knew that Alpha Titans, the Feeder Funds, the Master Fund, Trading Solutions and Montreux were related parties and that the Master Fund and Montreux paid Alpha Titans' operating expenses during the Feeder Funds' fiscal years 2009 through 2012. Lesser also knew that Alpha Titans had engaged McGladrey in order to comply with the custody rule.

20. Despite his knowledge of the relationship between Alpha Titans, the Feeder Funds, the Master Fund, Trading Solutions, and Montreux, Lesser approved the issuance of the audit reports which contained unqualified opinions on behalf of McGladrey for the Feeder Funds' and the Master Fund's fiscal years 2009 through 2012 financial statements.

21. Alpha Titans distributed to investors the Feeder Funds' and the Master Fund's audited financial statements, which were not prepared in accordance with GAAP. Because the audited financial statements were not GAAP compliant, Alpha Titans failed to meet the requirements for the exception to the custody rule found in Advisers Act Rule 206(4)-2(b)(4), for fiscal years 2009 through 2012.

Lesser Engaged in Improper Professional Conduct in Performing the Audits for the Feeder Funds and the Master Fund for Fiscal Years 2009 through 2012

Lesser Failed to Exercise Due Professional Care

22. McGladrey's audit reports for the Feeder Funds' and the Master Fund's financial statements state that the audits were conducted in accordance with GAAS. Lesser's audit work

was subject to American Institute of Certified Public Accountants ("AICPA") professional auditing standards. Lesser, as the lead engagement partner, was responsible for ensuring that the audit team complied with these professional standards. Lesser also was responsible for ensuring that the audit engagement team adequately documented in the work papers their findings, analysis and information on which they relied when forming the audit opinions.

23. Under GAAS, as codified in the Statements on Auditing Standards, auditors are required to exercise due professional care throughout the audit.[4] (AU § 230) Due professional care requires that the auditor exercise professional skepticism. Under this standard, "[p]rofessional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence." (AU § 230.07) "Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit process." (AU § 230.08) Additionally, standards dealing directly with related party transactions require that "the auditor should view related party transactions within the framework of existing [accounting] pronouncements, *placing primary emphasis on the adequacy of disclosure*." (AU § 334.02) (emphasis added) The auditor should apply procedures to obtain satisfaction about the related party transactions and the effect on financial statements. (AU § 334.09) For each "material related party transaction ... common ownership or management control relationship... the auditor should consider whether he has obtained sufficient appropriate audit evidence to understand the relationship of the parties and, ... the effects of the transaction on the financial statements." (AU § 334.11) Under the 2012 clarified standards, "[t]he auditor should plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated." (AU-C § 200.17) An auditor must obtain sufficient audit evidence in order to evaluate whether related party relationships and transactions have been appropriately identified, accounted for, and disclosed in the financial statements. (AU-C §§ 550.09b and 550.26a) The auditor has "responsibility to perform audit procedures to identify, assess, and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions, or balances." (AU-C § 550.04)

24. Lesser did not exercise the requisite level of care when conducting the audit and signing off on the Feeder Funds' and the Master Fund's audited financial statements for fiscal years 2009 through 2012. Lesser's knowledge that Alpha Titans' principal controlled the relevant entities and that the Master Fund and Montreux used Feeder Funds' assets to pay Alpha Titans' adviser-related operating expenses should have caused Lesser to place greater emphasis on the related party relationships and transactions, and the adequacy of the related party disclosures. He did not. The workpapers do not document the nature of the relationships between all the entities, the related party transactions of the Master Fund and Montreux paying Alpha Titans' adviser-related operating expenses, or the consideration of what disclosures, if any, should have been made in the financial statements and whether the financial statements complied with GAAP without the related party disclosures.

[4] GAAS and the professional standards are embodied in the Codification of Statements of Auditing Standards, as issued by the Auditing Standards Board of the AICPA. "AU" refers to the specific sections of the codification. The Auditing Standards Board redrafted the auditing sections in Codification of Statements on Auditing Standards (contained in AICPA Professional Standards) for clarity. These clarified standards are effective for audits ending on or after December 15, 2012, and will be referenced as "AU-C" herein.

Lesser Failed to Adequately Plan the Financial Statement Audits

25. An auditor must adequately plan the audit. (AU § 311) This standard requires that the auditor obtain a level of knowledge of the entity's business that will enable him to plan and perform his audit in accordance with GAAS. That level of knowledge should enable the auditor to obtain an understanding of the events, transactions, and practices that, in his judgment, may have a significant effect on the financial statements. In planning the audit, among other considerations, an auditor should understand the entity's business "and its environment, including its internal control." (AU § 311.03) As of 2012, an auditor should develop an audit plan that includes a description of: (a) the nature and extent of planned risk assessment procedures; (b) the nature, timing, and extent of planned further audit procedures; and (c) other planned audit procedures that are required to be carried out so that the engagement complies with GAAS. The auditor should also "update and change the overall audit strategy and audit plan, as necessary, during the course of the audit." (AU-C §§ 300.09 and 300.10)

26. As the engagement partner of the Feeder Funds' and the Master Fund's financial statement audits, Lesser failed to adequately plan the audits to address the possibility of material misstatement due to omitted related party disclosures. Although the audit team identified a risk of material misstatement concerning related parties for the 2009 audit, specifically "[h]igh volume of cash transfers between related parties (between the Funds)," and Lesser signed off on this work paper, Lesser did not document an audit plan in place to address this risk. In the 2010 and 2011 financial statement audits, the work papers did not even identify related party cash transfers or transactions as a risk of material misstatement. Further, Lesser did not plan the audit to address the high risks related to related parties even though he knew of the related party relationships and the related party transactions. In 2012, Lesser identified related party transactions as a significant risk, yet he still failed to properly address this risk and adequately plan the financial statement audits. While the audit work papers reflected increased procedures and testing of the related party transactions, there were no additional analyses or documentation concerning the continued omission of the related party disclosures from the financial statements. Similar to 2009 through 2011, in 2012, Lesser did not adjust the planned audit strategy to reevaluate whether related party disclosures were required by GAAP.

Lesser Failed to Obtain Sufficient Appropriate Audit Evidence Regarding Related Party Transactions

27. For the 2009 through 2011 audits, GAAS provided that an auditor must obtain sufficient appropriate audit evidence to afford a reasonable basis for an opinion regarding the financial statements under audit. (AU § 326.01) With respect to related party transactions, after identifying the transactions, the auditor should apply the procedures considered necessary to obtain satisfaction concerning the purpose, nature, and extent of those transactions and their effect on the financial statements. This may include taking the steps necessary to obtain "an understanding of the business purpose of the transaction" and examining supporting documentation, such as invoices and copies of contracts. (AU § 334.09) The auditing standards in effect for 2012 provide that "[t]he auditor should design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence." (AU-C § 500.06)

28. Lesser did not obtain sufficient appropriate evidence to determine whether related party transactions were adequately disclosed in the funds' financial statements. Although expenses that Montreux paid were reflected in the net investment performance of the Master Fund, there were no disclosures about the related party transactions themselves. In each year, the audit team looked at only one transaction in the Montreux bank account, which was unrelated to related party transactions. The audit documentation, including the "Summary of Significant Audit Findings or Issues" work paper, which Lesser signed off on, did not contain any analyses or conclusions on how the evidence supported the adequacy of the related party disclosures.

Lesser Failed to Prepare Adequate Audit Documentation

29. An "auditor must prepare audit documentation in connection with each engagement in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached." (AU §339.03) The 2012 auditing standards provide that "[t]he auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand" the nature, timing, extent, and results of the audit procedures performed, the evidence obtained, and significant findings or issues, conclusions reached, and significant professional judgments made in reaching those conclusions. (AU-C § 230.08) The auditor should also document "the names of the identified related parties and the nature of the related party relationships." (AU-C § 550.28)

30. Lesser failed to comply with these requirements. The audit documentation for the 2009 through 2012 financial statement audits, prepared and maintained by Lesser and the McGladrey audit team under his supervision, is not sufficient to enable an experienced auditor to understand the "nature, timing, extent and results of audit procedures performed" in a variety of areas. Although members of the audit team understood that the Feeder Funds, the Master Fund, Montreux, Trading Solutions and Alpha Titans were related parties, the related party relationships, transactions, analyses, and/or conclusions reached regarding the adequacy of related party disclosures were not reflected in the workpapers. In each year, the workpapers supporting the financial statement audits of the Feeder Funds, the Master Fund, Trading Solutions, and Montreux were all included in one audit file, but the documents did not describe the related party nature of the organizational structure, the related party relationships between all the funds, or the related party transactions between the Master Fund, Montreux and Alpha Titans. The workpapers also did not include any considerations, analyses or conclusions explaining Lesser's basis for believing that the financial statement disclosures were presented in accordance with GAAP despite the omitted related party information.

Lesser Was Responsible for the Issuance of Reports with Inaccurate Audit Opinions

31. GAAS requires auditors to state in the audit report whether the financial statements are presented in accordance with GAAP. (AU § 410.01) If management omits from the financial statements, including the accompanying notes, information that is required by GAAP, the auditor should express a qualified or adverse opinion and provide the information, if practicable. (AU § 431.03) Under the 2012 standards, an auditor should modify the opinion when it concludes that the financial statements as a whole are materially misstated or is unable to

obtain sufficient appropriate evidence to conclude that they are free from material misstatement. (AU-C § 705.07) For all years, GAAP required detailed disclosures about related party transactions, including disclosure of the nature of the relationships with the related parties, a description of the related party transaction and the related dollar amounts. (ASC 850-10-50-1)

32. As the lead engagement partner with ultimate responsibility for the Feeder Funds' and the Master Fund's financial statement audits for fiscal years 2009 through 2012, Lesser approved the issuance of audit reports containing unqualified opinions even though the related party relationships and transactions were not adequately disclosed in conformity with GAAP and McGladrey's audits were not conducted in accordance with GAAS. Because the required disclosures were omitted, McGladrey should not have issued audit reports containing unqualified opinions.

Lesser Failed to Properly Supervise the Financial Statement Audits

33. GAAS requires audit supervisors to supervise the planning and conduct of an audit. (AU §311.01) "Supervision involves directing the efforts of assistants who are involved in accomplishing the objectives of the audit and determining whether those objectives were accomplished." Elements of supervision include instructing assistants, keeping informed of significant issues, and reviewing the work. (AU § 311.28) For the 2012 audits, the engagement partner should have taken responsibility for the direction, supervision, and performance of the audit engagement in compliance with professional standards. (AU-C § 220.17) "The engagement partner should take responsibility for reviews being performed in accordance with the firm's review policies and procedures." (AU-C § 220.18) Moreover, the engagement partner should review the audit documentation, have discussions with the audit engagement team and "be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued." (AU-C § 220.19)

34. Lesser failed to adequately supervise the McGladrey staff auditors on the 2009 through 2012 financial statement audits. While Lesser understood the relationship among all of the relevant entities and that the Master Fund and Montreux paid Alpha Titans' adviser-related operating expenses using investor monies, he did not require the team to obtain sufficient appropriate evidence necessary to justify the omitted related party disclosures in the audited financial statements. He also did not appropriately address the significant issue of related party disclosures, direct his team to adjust the audit plan, strategy, or documentation, or properly determine whether related party disclosures were adequately evaluated by the engagement team.

E. VIOLATIONS

35. As a result of the conduct described above, Lesser willfully aided and abetted and caused Alpha Titans' violations of Section 206(4) of the Advisers Act and Rule 206(4)-2, the custody rule, promulgated thereunder.

36. Section 4C of the Exchange Act and Rule 102(e)(1)(iv) of the Commission's Rules of Practice define improper professional conduct with respect to persons licensed to practice as accountants. Section 4C of the Exchange Act and Rule 102(e)(1)(iv)(B)(2) of the Commission's Rules of Practice provide that improper professional conduct includes "[r]epeated

instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission."

37. As a result of the conduct described above, Lesser engaged in improper professional conduct within the meaning of Section 4C of the Exchange Act and Rule 102(e)(1)(iv)(B)(2) of the Commission's Rules of Practice. Lesser engaged in repeated instances of unreasonable conduct with respect to the 2009 through 2012 financial statement audits of the Alpha Titans' Feeder Funds and the Master Fund, which resulted in violations of professional standards.

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 Section 4C of the Exchange Act, Section 203(k) of the Advisers Act, Section 9(b) of the Investment Company Act, and Rule 102(e) of the Commission's Rules of Practice, it is hereby ORDERED that:

A. Lesser 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)-2 thereunder.

B. Lesser is denied the privilege of appearing or practicing before the Commission as an accountant.

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

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

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

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

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the quality control system relating to the work of Lesser that would indicate that Lesser 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 he 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, engagement quality reviews, and quality control standards.

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

E. Lesser shall, within 30 days of the entry of this Order, pay civil money penalties in the amount of $75,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.

F. 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 Lesser 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 C. Dabney O'Riordan, Division of Enforcement, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, California 90071.

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, that the findings in this Order are true and admitted by Respondent Lesser, 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74828 / April 29, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4073 / April 29, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31586 / April 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16520

In the Matter of ALPHA TITANS, LLC, TIMOTHY P. MCCORMACK, and KELLY D. KAESER, ESQ. Respondents.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 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) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to, Sections 203(e) 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 Alpha Titans LLC ("Alpha Titans"), Sections 203(f) and 203(k) of the Advisers Act and Section 9(b) of the Investment Company Act against Timothy P. McCormack ("McCormack"), and Section 4C[1] of the Securities Exchange Act of 1934 ("Exchange Act"),

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

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Sections 203(f) and 203(k) of the Advisers Act, Section 9(b) of the Investment Company Act, and Rule 102(e) of the Commission's Rules of Practice[2], against Kelly D. Kaeser ("Kaeser").

II.

In anticipation of the institution of these proceedings, Alpha Titans, McCormack and Kaeser (collectively, "Respondents") have submitted Offers of Settlement ("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, and except as provided herein in Section V as to McCormack, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934, Sections 203(e), 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) 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 Respondents' Offers, the Commission finds[3] that:

A. <u>SUMMARY</u>

1. Over a period of four years, Alpha Titans LLC ("Alpha Titans"), an investment adviser registered with the Commission that advises private funds, and its principal, Timothy P. McCormack, used fund assets to pay for adviser-related operating expenses in a manner (1) not clearly authorized under the funds' operating documents, and (2) not accurately reflected in the funds' financial statements as related party transactions. Alpha Titans breached its fiduciary duty when it used the assets of fund clients to pay its expenses without clear authorization in the funds' operating documents. Further, Alpha Titans and McCormack distributed materially misleading financial statements for the funds that inadequately and incorrectly described the total amount of Alpha Titans' expenses paid by the funds and the related party relationships. In addition, because

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The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

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

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

3 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.

the funds' financial statements did not reflect certain related party relationships and material transactions, they were not prepared in accordance with Generally Accepted Accounting Principles ("GAAP"), and thus Alpha Titans violated the custody rule. Alpha Titans also violated the compliance rule under the Advisers Act. Kelly D. Kaeser, Alpha Titans' general counsel and chief operating officer, aided and abetted and was a cause of these violations.

B. RESPONDENTS

2. **Alpha Titans LLC** is a California limited liability company based in Santa Barbara, California. It has been registered with the Commission as an investment adviser since 2007. As a registered investment adviser, Alpha Titans is subject to the custody rule promulgated under Section 206(4) of the Advisers Act and set forth as Rule 206(4)-2 thereunder. In lieu of submitting to surprise examinations, Alpha Titans elected to comply with the custody rule by distributing to the private funds' investors annual audited financial statements prepared in accordance with GAAP, and audited by an independent public accountant registered with, and subject to regular inspection by, the PCAOB, within 120 days of the end of the fiscal year.

3. **Timothy P. McCormack**, age 58, is a resident of Santa Barbara, California. McCormack is Alpha Titans' founder, 95% owner, chief executive officer, managing member, chief investment officer and chief compliance officer. Before starting Alpha Titans in 2007, McCormack owned Santa Barbara Alpha Strategies, Inc. ("SBAS"), an investment adviser formerly registered with the Commission. In 2007, he rolled SBAS's operations and employees over to Alpha Titans and later dissolved SBAS. At all relevant times, McCormack was responsible for the management of Alpha Titans' business.

4. **Kelly D. Kaeser, Esq.**, age 46, is a resident of Moorpark, California. He has been Alpha Titans' general counsel since 2007 and chief operating officer since 2009. From 2006 to 2009, Kaeser was general counsel for SBAS, and from 2005 to 2006, he worked for a small, private law firm specializing in employment law. Kaeser is an attorney currently licensed in the state of California and has appeared and practiced before the Commission.

C. OTHER RELEVANT ENTITIES

5. **Alpha Titans LP**, a Delaware limited partnership, is an onshore hedge fund formed by McCormack in September 2007; Alpha Titans is the general partner. **Alpha Titans, Ltd.**, a Cayman Islands exempted company, is an offshore hedge fund formed by McCormack in October 2007 and managed by Alpha Titans. **Alpha Titans MF SPC** (the "Master Fund"), a Cayman Islands segregated portfolio company, is a hedge fund formed by McCormack in October 2007. Alpha Titans pools together assets from Alpha Titans LP and Alpha Titans, Ltd. by investing their assets in the Master Fund. Alpha Titans and McCormack control these funds.

6. **Montreux Partners SPC** ("Montreux"), a Cayman Islands exempted segregated portfolio company, and **Trading Solutions Ltd.** ("Trading Solutions"), a Cayman Islands exempted company, are special purpose vehicles for use with the Master Fund's investments. McCormack formed Montreux and Trading Solutions in February 2008 and June 2009, respectively, and he directed all activities, management and operating policies of both entities.

D. FACTS

Background

7. Alpha Titans, an investment adviser founded and operated by McCormack, is the general partner of Alpha Titans LP and the manager of Alpha Titans, Ltd. (collectively, the "Feeder Funds"). Limited partners and shareholders invested money in the Feeder Funds. McCormack then directed that money to flow to the Master Fund. The Master Fund purchased equity options from Trading Solutions with the Feeder Funds' money. Trading Solutions invested that money in Montreux. Ultimately, Montreux used the Feeder Funds' money to invest in unrelated private funds. McCormack formed and directed all activities, management and operating policies of Alpha Titans, the Feeder Funds, the Master Fund, Trading Solutions and Montreux.

8. Investments in the Feeder Funds are primarily governed by private placement memoranda ("PPMs") and the funds' respective limited partnership and operating agreements, which Kaeser created for each fund. Kaeser also prepared Alpha Titans' Forms ADV and amendments thereto, which were filed with the Commission in order to register Alpha Titans as an investment adviser and maintain such registration. McCormack assisted with the preparation of the PPMs, agreements, and Forms ADV, and ultimately approved each of them.

9. The Feeder Funds paid Alpha Titans management and performance fees. In 2009 and 2010, Alpha Titans charged the Feeder Funds management fees of 1% annually; in 2011 and 2012, Alpha Titans charged the Feeder Funds management fees ranging from 1% to 2% annually. During the relevant time period, the Feeder Funds paid Alpha Titans over $2 million in management fees.

Alpha Titans Used Feeder Funds' Assets to Pay Its Own Expenses, Which Was Not Clearly Authorized by the Feeder Funds' Operational Documents

10. Alpha Titans and McCormack paid most of Alpha Titans' operational expenses with the Feeder Funds' assets, including Alpha Titans' employee salaries and health benefits, rent, parking, utilities, computer equipment, technology services, and other operational costs. The use of fund assets to pay for these expenses created significant conflict of interest between Alpha Titans and McCormack on the one hand, and the Feeder Funds on the other.

11. In particular, after the Feeder Funds' assets were invested in the Master Fund and, ultimately, invested in Montreux, McCormack authorized the Master Fund and Montreux to pay most of Alpha Titans' operational expenses. Kaeser also made some of these payments from the Montreux account.

12. Alpha Titans LP's PPMs dated August 2009 and later, contained the following disclosure:

> The Partnership bears all of the expenses incurred by it or by others on its behalf or for its benefit, including ordinary operational and administrative expenses, expenses incurred in connection with the continuing offering of the Interests, expenses incurred in direct or indirect investment activities,

> financing and transaction costs, interest expenses on funds borrowed on its behalf, and extraordinary expenses, if any. For example, the Partnership bears a pro rata portion of certain operational, administrative and other expenses of the General Partner that are incurred for the benefit of the Partnership.

13. Alpha Titans Ltd.'s PPMs dated August 2009 and later, contained a similar disclosure, but it replaced "Partnership" for "Company" to reflect the organizational structure of that fund.

14. Alpha Titans, McCormack and Kaeser distributed the Feeder Funds' August 2009 PPMs (and similar iterations dated thereafter) to new investors in the Feeder Funds and to existing investors who made new investments after August 2009.

15. While the operating and limited partnership agreements provided that "[t]he Fund shall bear all the costs and expenses of its operation," the agreements did not contain any language stating that the Feeder Funds would bear the cost of any of Alpha Titans' operational or administrative expenses.

16. The only PPM the investors who first invested in the Feeder Funds after August 2009 received was the PPM with the language excerpted above in paragraph 12. By contrast, those investors who had first invested in the Feeder Funds before August 2009 received a more detailed expense disclosure about the type and scope of Alpha Titans' expenses that the Feeder Funds would pay. McCormack and Kaeser later revised the PPMs, removing this more specific disclosure along with approximately ten pages of text from each PPM. As a result, Alpha Titans and McCormack were not clearly authorized to use the Feeder Funds' assets to pay most of Alpha Titans' operational expenses with money raised from investors who received the inadequate expense disclosure after August 2009. Of the total payments made from the Feeder Funds' assets to pay Alpha Titans' expenses, $469,522 is attributable to money raised by Alpha Titans and McCormack from investors who invested after August 2009 and received only the inadequate disclosure.

Alpha Titans' Forms ADV Did Not Disclose That It Used Client Assets to Pay Most of Its Operational Expenses

17. Alpha Titans' Form ADV Parts 1 and 2 for 2009 through 2012 did not disclose that Alpha Titans' clients paid most of Alpha Titans' operating expenses, which constituted compensation to the adviser.

18. Item 5.E of Part 1 of Form ADV for 2009, 2010, 2011 and 2012 required that an investment adviser identify the ways it is "compensated for providing [its] investment advisory services." In response, Alpha Titans indicated only that it received a percentage of assets under management and performance-based fees. Alpha Titans did not disclose that, in addition to such amounts, Alpha Titans' clients paid most of the adviser's operating expenses, which constituted compensation to the adviser, even though Item 5.E required an investment adviser to indicate whether it received "other" forms of compensation, and to specify the nature of that compensation.

19. Items 1.A and 1.D of Part 2 of Form ADV for 2009 and 2010 required that an investment adviser provide, on Schedule F, the adviser's "basic fee schedule" and "how fees are charged." In response, Alpha Titans indicated that it received "asset-based management fees" and "performance based compensation." Alpha Titans did not disclose that, in addition to such amounts, Alpha Titans' clients paid most of the adviser's operating expenses, which constituted compensation to the adviser.

20. Items 5.A and 6 of Part 2A of Form ADV for 2011 and 2012 required that an investment adviser describe in its Brochure how the adviser is compensated for advisory services. In response, Alpha Titans indicated that it received "asset-based management fees" and "performance based compensation." Alpha Titans did not disclose that, in addition to such amounts, Alpha Titans' clients paid most of the adviser's operating expenses, which constituted compensation to the adviser.

21. McCormack signed the 2009, 2010, 2011 and 2012 Forms ADV for Alpha Titans.

<u>The Audited Financial Statements Failed to Disclose the Feeder Funds' Payment of Adviser-Related Operating Expenses and Thus, Were Not in Compliance with GAAP</u>

22. Alpha Titans, as part of its reliance on the exception to the custody rule for an adviser to a pooled investment vehicle found in Rule 206(4)-2(b)(4), engaged a PCAOB-registered auditor as the Feeder Funds' and the Master Fund's independent public accountant to audit their financial statements for the fiscal years ended December 31, 2009, 2010, 2011 and 2012. To comply with the custody rule, Alpha Titans apparently intended to provide the Feeder Funds' limited partners and shareholders with GAAP-compliant financial statements of the Feeder Funds and the Master Fund, pursuant to the custody rule exception found in Advisers Act Rule 206(4)-2(b)(4).

23. GAAP provides disclosure requirements for related party relationships and transactions in financial statements. (*See, generally*, Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 850-10-50) Alpha Titans, the Feeder Funds, the Master Fund, Montreux and Trading Solutions were related parties because, for purposes of GAAP, McCormack had common control over each entity since McCormack formed and directed all investment activities and operating policies of each entity. (*See* ASC 850-10-20, *et seq.*) At McCormack's directive, Kaeser performed work on behalf of each entity, and Kaeser knew that McCormack had common control over all of the entities. This common control allowed McCormack to pay Alpha Titans' adviser-related operational expenses, including employee salaries, rent and other related expenses, using money held by Montreux and the Master Fund. This led to operating results of the Feeder Funds and the Master Fund that could have been "significantly different" from those that would have been obtained if McCormack did not have the control and ability to cause these entities to pay Alpha Titans' adviser-related operating expenses. (*See* ASC 850-10-50-6) The Master Fund's and Montreux's payments of Alpha Titans' adviser-related operating expenses were material related party transactions in fiscal years 2009 through 2012.

24. The Feeder Funds' and the Master Fund's audited financial statements for fiscal years 2009 through 2012 were not in compliance with GAAP. In particular, the Feeder Funds'

and the Master Fund's audited financial statements for fiscal years 2009 through 2012 did not disclose (i) the related party relationships among Alpha Titans, the Feeder Funds, the Master Fund, Trading Solutions and Montreux, and McCormack's common control of these entities, and (ii) the material related party transactions concerning the Master Fund's and Montreux's payments of Alpha Titans' adviser-related operating expenses.

25. Neither the Feeder Funds' nor the Master Fund's 2009 financial statements disclosed (i) the related party relationships, (ii) that Montreux paid $208,712 of related party expenses, and (iii) that $287,420 of the Master Fund's operating expenses were related party transactions. The 2009 financial statements for the Feeder Funds included a note disclosing (collectively) only $318 of related party transactions and did not make any disclosure as to the related party relationships. Further, the Master Fund's financial statements included operating expenses totaling $319,823, but did not disclose that $287,420 (or 90%) was attributable to Alpha Titans' employee payroll and benefits, which were related party transactions. Rather, the notes to the financial statements disclosed only $1,226 in related party transactions and did not describe the related party relationships.

26. Neither the Feeder Funds' nor the Master Fund's 2010 financial statements disclosed (i) the related party relationships, (ii) that Montreux paid $361,429 of related party expenses, and (iii) that all of the Master Fund's operating expenses were related party transactions. Instead, the 2010 financial statements for the Feeder Funds included a note indicating there were no related party transactions. For example, in Alpha Titans LP's 2010 financial statements, the note provided "Pursuant to the terms of the Fund's limited partnership, the General Partner is able to pay expenses on behalf of the Fund and subsequently be reimbursed for actual overhead costs and expenses that are directly connected with the management and operations of the Fund. For the year ended December 31, 2010, there was no reimbursement." The Master Fund's financial statements included operating expenses totaling $634,895, but did not disclose that 100% of it was attributable to Alpha Titans' employee payroll and benefits, which were related party transactions. Rather, the notes to the financial statements disclosed only $1,043 in related party transactions and did not explain the related party relationships.

27. Neither the Feeder Funds' nor the Master Fund's 2011 financial statements disclosed (i) the related party relationships, (ii) that Montreux paid $537,999 of related party expenses, and (iii) that $614,995 of the Master Fund's operating expenses were related party transactions. Instead, the 2011 financial statements for the Feeder Funds and the Master Fund included a note indicating there were no related party transactions. For example, in Alpha Titans LP's 2011 financial statements, the note provided "Pursuant to the terms of the Fund's limited partnership agreement, the General Partner is able to pay expenses on behalf of the Fund and subsequently be reimbursed for actual overhead costs and expenses that are directly connected with the management and operations of the Fund. For the year ended December 31, 2011, there was no reimbursement." The Master Fund's financial statements included operating expenses totaling $700,736, but did not disclose that $614,995 (or 88%) was attributable to Alpha Titans' employee payroll, benefits, and other employee payments, which were related party transactions.

28. Neither the Feeder Funds' nor the Master Fund's 2012 financial statements disclosed (i) all the related party relationships, and (ii) that Montreux paid $339,639 of related

party expenses. Instead, the 2012 financial statements for the Feeder Funds included a note indicating there were no related party transactions. For example, in Alpha Titans LP's 2012 financial statements, the note provided "Pursuant to the terms of the Fund's limited partnership agreement, the General Partner is able to pay expenses on behalf of the Fund and subsequently be reimbursed for actual overhead costs and expenses that are directly connected with the management and operations of the Fund. For the year ended December 31, 2012, there was no reimbursement." The Master Fund's financial statements included operating expenses totaling $781,732. Unlike previous years, the notes to the financial statements provided some additional detail, explaining that "During 2012, employees of the Investment Manager did provide services to the Company in the amount of $467,267 and were paid by the Company."

29. Overall, from 2009 through 2012, Montreux paid a total of $1,447,777 in related party transactions that were not disclosed in the Feeder Funds' or the Master Fund's financial statements. In addition, from 2009 through 2011, the Master Fund paid a total of $1,537,309 of Alpha Titans' employee payroll, benefits and other employee payments that were not identified as related party transactions in the notes to the financial statements, but instead were listed simply as "operating expenses" on the income statement for the Master Fund.

30. McCormack and Kaeser each reviewed the financial statements. In addition, McCormack signed the Feeder Funds' and Master Fund's management representations letters to the auditor for the 2009 financial statements, and McCormack and Kaeser signed the Feeder Funds' and Master Fund's management representations letters to the auditor for the 2010, 2011 and 2012 financial statements. Each management representation letter inaccurately stated that the related party relationships and transactions had been properly recorded and disclosed in the financial statements.

31. For the 2009 through 2012 fiscal year-ends, the audit reports from the PCAOB-registered auditor attached to the Feeder Funds' and Master Fund's financial statements stated that the auditor had audited each financial statement in accordance with generally accepted auditing standards, and included unqualified opinions for each entity, in each year, that the financial statements were presented fairly in conformity with GAAP. This was inaccurate, as the audited financial statements were not GAAP compliant.

32. Alpha Titans, McCormack and Kaeser distributed to investors the Feeder Funds' and the Master Fund's audited financial statements, which were not prepared in accordance with GAAP. Because the audited financial statements were not GAAP compliant, Alpha Titans, with substantial assistance from McCormack and Kaeser, failed to meet the requirements for the exception to the custody rule found in Advisers Act Rule 206(4)-2(b)(4), for fiscal years 2009 through 2012.

33. In addition, Alpha Titans, McCormack and Kaeser did not otherwise supplement the inaccurate financial statements by advising the Feeder Funds' investors of the total amount of Alpha Titans' operational expenses paid using the Feeder Funds' assets. Thus, the Feeder Funds' investors were misled as to the total amount of fund assets that were used to pay these expenses.

Alpha Titans Had Inadequate Compliance Policies and Procedures

34. McCormack and Kaeser were responsible for preparing, reviewing and updating Alpha Titans' written compliance policies and procedures.

35. From 2009 through 2012, Alpha Titans' compliance manual did not include policies and procedures to address McCormack's control of related parties, and how that control might affect related party transactions and required disclosures. In particular, the manual lacked provisions reasonably designed to prevent violations of the Advisers Act arising from failures to disclose material conflicts of interest or to act in the best interest of clients in connection with related party transactions involving Alpha Titans' private fund clients.

E. VIOLATIONS

36. As a result of the conduct described above, Alpha Titans and McCormack willfully[4] violated, and Kaeser willfully aided and abetted and caused their violation of, Section 206(2) of the Advisers Act, which makes it unlawful for any investment adviser, directly or indirectly, to "engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client." Scienter is not required to establish a violation of Section 206(2), but rather may rest on a finding of negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180,194-95 (1963)).

37. As a result of the conduct described above, Alpha Titans and McCormack willfully violated, and Kaeser willfully aided and abetted and caused their violation of, Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which makes it unlawful for any investment adviser to a pooled investment vehicle to "[m]ake any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle" or "engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle." A violation of Section 206(4) and the rules thereunder does not require scienter. *Steadman*, 967 F.2d at 647.

38. As a result of the conduct described above, Alpha Titans willfully violated, and McCormack and Kaeser willfully aided and abetted and caused Alpha Titans' violations of, Section 206(4) of the Advisers Act and Rule 206(4)-2, the custody rule, promulgated thereunder.[5] The custody rule imposes specific requirements on registered advisers who have custody of client funds and securities. Alpha Titans had custody of client funds and securities within the meaning of the rule. Among other things, the custody rule generally requires that

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

[5] The custody rule was amended in December 2009, effective March 12, 2010. Here, the violations relate to both the pre- and post-amendment versions of the rule.

client assets be maintained with a qualified custodian, who must provide account statements to the investors at least quarterly, and requires client assets to be verified through an annual surprise examination by an independent public accountant. Rule 206(4)-2(b)(4) provides an exception to these requirements with respect to certain pooled investment vehicles. This exception, upon which Alpha Titans purported to rely, requires the vehicle to be audited by an independent public accountant, and requires GAAP-compliant audited financial statements to be distributed to investors within 120 days of the end of the vehicle's fiscal year. As a result of the conduct described above, the financial statements of the Feeder Funds and the Master Fund for fiscal years 2009 through 2012 were not GAAP compliant.

39. As a result of the conduct described above, Alpha Titans willfully violated, and McCormack and Kaeser willfully aided and abetted and caused Alpha Titans' violations of, Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder, which require investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and its rules.

40. As a result of the conduct described above, Alpha Titans and McCormack 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." Scienter is not required to establish liability under Section 207 of the Advisers Act; it merely requires willfulness. *SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1309 (S.D. Fla. 2007).

F. <u>CIVIL PENALTIES</u>

41. Respondent Kaeser has submitted a sworn Statement of Financial Condition dated December 15, 2014 and other evidence and has asserted his inability to pay a civil penalty.

G. <u>UNDERTAKINGS</u>

42. Before the entry of this Order, Respondents Alpha Titans and McCormack had begun winding down the operations of Alpha Titans MF SPC, Alpha Titans LP, and Alpha Titans, Ltd. (the "Funds"), and shall continue that process. As part of that process, Alpha Titans and McCormack had discontinued the solicitation or acceptance of any investments for these or any other private funds from existing or new clients. Respondent Alpha Titans shall continue not to solicit or accept any new investments, including but not limited to capital contributions to the Funds or any other private funds, from its clients or others, and Alpha Titans shall not solicit or accept new clients.

43. Within thirty (30) days of entry of this Order, Respondents Alpha Titans and McCormack shall engage, at McCormack's own expense, an independent monitor ("Monitor") who is not unacceptable to the Commission staff, to:

i. oversee the completion of the winding down of the Funds' operations;

ii. submit to the Commission staff a quarterly report describing the status of the wind down and the status of all assets of the Funds; and

iii. report any potential irregularities or misconduct involving the Funds or Alpha Titans to the Commission staff on an ongoing basis.

44. Respondents Alpha Titans and McCormack shall fully cooperate with the Monitor and provide the Monitor with access to any and all accounting and financial records and other documents and information the Monitor may request for review in the course of his/her/its duties.

45. Where practicable, Respondents Alpha Titans and McCormack shall provide the Monitor with five (5) days advance notice of all transactions involving more than $50,000 of the Funds' assets; and for transactions where such notice is not practicable, Alpha Titans and McCormack shall provide the Monitor with notice of the completed transaction within two (2) business days after completion.

46. Respondents Alpha Titans and McCormack shall retain the Monitor, at McCormack's own expense, from the date of the engagement of the Monitor until such date when the Funds have ceased operations.

47. Respondent Alpha Titans shall not receive any compensation, including any salary, bonus or fees, from the Funds, and Respondent McCormack shall not receive any compensation, including any salary, bonus or fees, from Alpha Titans or the Funds.

48. Respondents Alpha Titans and McCormack shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondents agree to provide such evidence. The certification and supporting material shall be submitted to Marshall S. Sprung, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 444 S. Flower Street, Suite 900, Los Angeles, CA 90071, with a copy to the Office of Chief Counsel of the Division of Enforcement, Securities and Exchange Commission, 100 F. Street, NE, Washington, DC 20549, 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 and in the public interest to impose the sanctions agreed to in Respondents' Offers.

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

A. Respondents Alpha Titans and McCormack shall cease and desist from committing or causing any violations and any future violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-2, 206(4)-7, and 206(4)-8 promulgated thereunder;

B. Respondent Kaeser shall cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-2, 206(4)-7, and 206(4)-8 promulgated thereunder;

C. Respondent Alpha Titans shall be censured;

D. Respondents McCormack and Kaeser shall be, and hereby are:

(1) suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent or nationally recognized statistical rating organization for a period of twelve months, effective on the second Monday following the entry of this Order; and

(2) 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 months, effective on the second Monday following the entry of this Order;

provided, however, that McCormack may continue to remain associated with Alpha Titans (subject to oversight from the Monitor as provided in paragraphs 41 through 47 above) for not more than ninety (90) days, unless otherwise extended by the staff for good cause shown, to the extent necessary to (i) wind down the operations of the Funds and perform such functions as are necessary for such winding down, and (ii) administer the Disgorgement Fund as described in Subsections E(1) through E(10) below.

E. Respondents Alpha Titans and McCormack shall pay disgorgement and prejudgment interest as follows:

(1) Respondents Alpha Titans and McCormack on a joint and several basis shall pay disgorgement of $469,522 and prejudgment interest of $28,928.14, consistent with the provisions of this Subsection E. Within ten (10) days of the entry of this Order, Alpha Titans and McCormack shall deposit the full amount of the disgorgement and prejudgment interest (the "Disgorgement Fund") into an escrow account acceptable to the Commission staff and Alpha Titans and McCormack shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. If timely deposit of the Disgorgement Fund is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

(2) Alpha Titans and McCormack shall be responsible for administering the Disgorgement Fund. Alpha Titans and McCormack shall pay applicable portions of the Disgorgement Fund to the affected current and former investors in the Feeder Funds who invested in, or any time after, August 2009, while in receipt of the inadequate disclosures (the "Payees"),

pursuant to a disbursement calculation (the "Calculation") that has been submitted to, and reviewed and approved by, the Commission staff in accordance with this Subsection E. No portion of the Disgorgement Fund shall be paid to any Payee directly or indirectly in the name of or for the benefit of Alpha Titans, McCormack or Kaeser, or any person with an ownership interest in Alpha Titans. Any such funds shall be transferred to the Commission for transfer to the United States Treasury in accordance with Subsection F below. For any current and former investor that is due an amount totaling less than ten dollars ($10.00), Alpha Titans and McCormack shall instead pay such amount to the Commission for transfer to the United States Treasury in the manner provided in Subsection F below.

(3) Alpha Titans and McCormack shall, within thirty (30) days from the entry of this Order, submit a proposed Calculation to the Commission staff for its review and approval that identifies, at a minimum: (i) the name of each affected fund and the name of each Payee; (ii) the percentage interest in the fund held by the Payee; and (iii) the exact amount of the payment to be made to the Payee. Alpha Titans and McCormack shall also provide to the Commission staff such additional information and supporting documentation as the Commission staff may request for the purpose of its review. In the event of one or more objections by the Commission staff to Alpha Titans' and McCormack's proposed Calculation and/or any of its information or supporting documentation, Alpha Titans and McCormack shall submit a revised Calculation for the review and approval of the Commission staff and/or additional information or supporting documentation within ten (10) days of the date that Alpha Titans and McCormack are notified of the objection, which revised Calculation shall be subject to all of the provisions of this Subsection E.

(4) Alpha Titans and McCormack shall complete the transmission of all amounts otherwise payable to the Payees pursuant to the approved Calculation within ninety (90) days of the entry of this Order, unless such time period is extended as provided for in Subsection E(10) below.

(5) If Alpha Titans and McCormack do not distribute or return any portion of the Disgorgement Fund for any reason, including an inability to locate a Payee or any factors beyond Alpha Titans' and McCormack's control, or if Alpha Titans and McCormack have not transferred any portion of the Disgorgement Fund to a Payee because that Payee is due less than $10.00, Alpha Titans and McCormack shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury after the final accounting provided for in this Subsection E(7) is approved by the Commission. Any such payment shall be made in accordance with Subsection F below.

(6) Alpha Titans and McCormack shall be responsible for any and all tax compliance responsibilities associated with the Disgorgement Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Alpha Titans and McCormack and shall not be paid out of the Disgorgement Fund.

(7) Within ninety (90) days after the date of entry of this Order, Alpha Titans and McCormack shall submit for Commission staff approval a final accounting of the disposition of the Disgorgement Fund. The final accounting shall be on a standardized accounting form to be provided by the Commission staff and 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; (iv) the date and amount of any returned payment; and (v) any amounts to be forwarded to the Commission for transfer to the United States Treasury. In addition, Alpha Titans and McCormack shall provide to Commission staff a cover letter representing that all of the requirements of this Subsection E have been completed and that the information requested has been accurately reported to the Commission ("the certification"). Also included in the certification should be a description of any efforts to locate a prospective Payee whose payment was returned or to whom payment was not made for any reason.

(8) Alpha Titans and McCormack shall submit proof and supporting documentation of such payment (whether in the form of cancelled checks, wire receipts, or otherwise) in a form acceptable to the Commission staff and under a cover letter that identifies Alpha Titans and McCormack as Respondents in these proceedings and the file number of these proceedings to C. Dabney O'Riordan, Assistant Regional Director, Asset Management Unit, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA, 90071, or such other address the Commission staff may provide. Alpha Titans and McCormack shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.

(9) After Alpha Titans and McCormack have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send any remaining amount to the United States Treasury.

(10) The Commission staff may extend any of the procedural dates set forth in this Subsection E for good cause shown. Deadlines for dates relating to the Disgorgement Fund 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.

F. Respondents Alpha Titans and McCormack on a joint and several basis shall, within ten (10) days of entry of the Order, pay a civil money penalty in the total amount of $200,000 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) Respondents Alpha Titans and McCormack may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondents Alpha Titans and McCormack 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 Alpha Titans and McCormack 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 Alpha Titans and McCormack 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 Marshall Sprung, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, California 90071.

G. Based upon Respondent Kaeser's sworn representations in his Statement of Financial Condition dated December 15, 2014, and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent Kaeser.

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

I. Respondent Kaeser is suspended from appearing or practicing before the Commission as an attorney for 12 months from the date of this Order.

J. After 12 months from the date of the Order, Respondent Kaeser 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 the General Counsel.

K. In support of such an application, Respondent Kaeser must provide a certificate of good standing from each state bar where he is a member.

L. In support of such an application, Respondent Kaeser must also submit an affidavit truthfully stating, under penalty of perjury:

(1) that Respondent Kaeser has complied with the Order;

(2) that Respondent Kaeser:

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 Kaeser, 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 Kaeser, 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.

M. If Respondent Kaeser provides the documentation required in Paragraphs K and L, 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.

N. If Respondent Kaeser is not able to truthfully attest to the statements required in Subparagraphs L(2)(b) or L(4), Respondent Kaeser 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.

O. Respondents Alpha Titans and McCormack shall comply with the undertakings enumerated in Section III.42 through III.48 above.

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, that the findings in this Order are true and admitted by Respondent McCormack, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent McCormack 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 McCormack 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.

Brent J. Fields
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 242

Release No. 34-74834; File No. S7-06-15

RIN 3235-AL73

Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed By Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; proposed rule amendments.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is publishing for comment proposed amendments and a re-proposed rule 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. The Commission is proposing amendments to Exchange Act rules 3a71-3 and 3a71-5 that would address the application of the de minimis exception to security-based swap transactions connected with a non-U.S. person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel of such person located in a U.S. branch or office, or by personnel of such person's agent, located in a U.S. branch or office. The Commission is also re-proposing Exchange Act rule 3a71-3(c) and proposing certain amendments to Exchange Act rule 3a71-3(a) to address the applicability of external business conduct requirements to the U.S. business and foreign business of registered security-based swap dealers. The Commission also is proposing amendments to Regulation SBSR to apply the regulatory reporting and public dissemination requirements to transactions that are arranged, negotiated, or executed by personnel of non-U.S. persons, or

personnel of such non-U.S. persons' agents, that are located in the United States and to transactions effected by or through a registered broker-dealer (including a registered security-based swap execution facility), along with certain related issues, including requiring registered broker-dealers (including registered security-based swap execution facilities) to report certain transactions that are effected by or through the registered broker-dealer.

DATES: Comments should be received on or before **[insert date 60 days after publication in Federal Register]**.

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-06-15 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 S7-06-15. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the SEC's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Carol McGee, Assistant Director, Richard Gabbert, 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 proposing the following rules under the Exchange Act regarding the application of Subtitle B of Title VII of the Dodd-Frank Act to cross-border activities.

The Commission is proposing to amend the following rules under the Exchange Act: rule 3a71-3 (addressing the cross-border implementation of the de minimis exception to the "security-based swap dealer" definition and the definition of certain terms); rule 3a71-5 (regarding availability of an exception from the dealer de minimis analysis for cleared anonymous transactions that fall within proposed rule 3a71-3(b)(1)(iii)(C)); and Rules 900, 901, 906, 907, 908(a)(1), and 908(b) of Regulation SBSR. The Commission also is re-proposing Exchange Act rule 3a71-3(c) (application of external business conduct requirements).

I. Background

A. Scope of this Rulemaking

The Commission is proposing to amend certain rules and is re-proposing a rule regarding the application of Title VII of the Dodd-Frank Act[1] ("Title VII") to cross-border security-based swap transactions and persons engaged in those transactions. The proposed amendments include rules regarding the application of the de minimis exception to the dealing activity of non-U.S. persons carried out, in relevant part, by personnel located in the United States,[2] and the application of Regulation SBSR[3] to such transactions and to transactions effected by or through a registered broker-dealer, along with certain related issues. We are also re-proposing a rule regarding the application of external business conduct requirements to the foreign business and U.S. business of registered security-based swap dealers.

Each of these issues was considered in our May 23, 2013 proposal, in which we proposed rules regarding the application of Title VII in the cross-border context more generally.[4] On June 25, 2014, we adopted rules and guidance based on the May 23, 2013 proposal 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 In this release, unless otherwise noted, we use the terms "personnel located in the United States" or "personnel located in a U.S. branch or office" interchangeably to refer to personnel of the non-U.S. person engaged in security-based swap dealing activity who are located in a U.S. branch or office, or to personnel of an agent of such non-U.S. person who are located in a U.S. branch or office.

3 Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information; Final Rule, Exchange Act Release No. 74244 (February 11, 2015), 80 FR 14563 (March 19, 2015) ("Regulation SBSR Adopting Release"). With these proposed rules and rule amendments, the Commission is not re-opening comment on the rules adopted in Regulation SBSR Adopting Release.

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").

application of the "security-based swap dealer" and "major security-based swap participant" definitions to cross-border security-based swap activities.[5] In that release, among other things, we adopted rules specifying which cross-border transactions must be included in a person's security-based swap dealer de minimis or major security-based swap participant calculations.[6] We explained, however, that we were not addressing the application of the "security-based swap dealer" definition to "transaction[s] conducted within the United States" because commenters had raised several significant issues related to this requirement of the proposal.[7] We stated that we anticipated soliciting additional public comment on the application of the "security-based swap dealer" definition to transactions between two non-U.S. persons where one or both are conducting dealing activity within the United States.[8]

In this release, we propose amendments to Exchange Act rules 3a71-3 and 3a71-5 that reflect a modified approach to this element of the initial proposal and solicit comment on the proposed amendments and re-proposed rule. The proposed amendments would address the activity of a non-U.S. person in the United States in a way that more closely focuses on where personnel of the non-U.S. person engaged in dealing activity (or on where personnel of its agent) are arranging, negotiating, or executing a security-based swap. The proposed amendments would not require a non-U.S. person engaging in dealing activity to consider the location of its non-U.S.-person counterparty or the counterparty's agent in determining whether the transaction

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5 See Application of "Security-Based Swap Dealer" and "Major-Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities, Exchange Act Release No. 72472 (June 25, 2014), 79 FR 47278 (August 12, 2014 (republication)) ("Cross-Border Adopting Release"). With these proposed rules and rule amendments the Commission is not re-opening comment on the rules adopted in the Cross-Border Adopting Release.

6 See id. at 47279.

7 See id. at 47279-80.

8 See id. at 47280.

needs to be included in its own de minimis calculation. Instead, the proposed amendments would require a non-U.S. person to include in its de minimis calculation any transaction with another non-U.S. person that is, in connection with its dealing activity, arranged, negotiated, or executed by personnel of the non-U.S. person located in a U.S. branch or office or by personnel of the non-U.S. person's agent located in a U.S. branch or office.

We also are re-proposing rules regarding the application of the external business conduct requirements to the foreign business of registered security-based swap dealers, and we are proposing to amend Regulation SBSR to address the reporting and public dissemination requirements applicable to security-based swap transactions involving non-U.S. persons that engage in relevant activity in the United States and to transactions effected by or through a registered broker-dealer, along with certain related issues.

B. The Dodd-Frank Act

Title VII of the Dodd-Frank Act 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 security-based swap dealers and major security-based swap participants, as well as requirements related to clearing, trade execution, regulatory reporting, and public dissemination.[9] Security-based swap transactions are

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9 We have proposed a series of rules regarding these matters. See Cross-Border Proposing Release, 78 FR 30972 nn.11-18.

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 largely cross-border in practice,[10] and the various market participants and infrastructures operate in a global market. Dealers and other market participants may transact extensively with counterparties established or located in other jurisdictions and, in doing so, may conduct sales and trading activity in one jurisdiction and book the resulting transactions in another. These market realities and the potential impact that these activities may have on U.S. persons and potentially the U.S. financial system have informed our consideration of these proposed rules.

In developing this proposal, we have consulted and coordinated with the CFTC, the prudential regulators,[11] and foreign regulatory authorities in accordance with the consultation mandate of the Dodd-Frank Act.[12] More generally, as part of our domestic and international efforts, Commission staff has participated in numerous bilateral and multilateral discussions with

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Contract Participant," Exchange Act Release No. 66868 (April 27, 2012), 77 FR 30596 (May 23, 2012) ("Intermediary Definitions Adopting Release"); see also Cross-Border Proposing Release, 78 FR 30972 n.9 (discussing joint rulemaking to further define various Title VII terms).

10 See Section II.B.2, infra, regarding the preponderance of cross-border activity in the security-based swap market.

11 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.

12 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."

foreign regulatory authorities addressing the regulation of OTC derivatives.[13] Through these discussions and the Commission staff's participation in various international task forces and working groups,[14] we have gathered information about foreign regulatory reform efforts and their impact on and relationship with the U.S. regulatory regime. We have taken this information into consideration in developing this proposal.

C. The Cross-Border Proposing Release

Our prior proposals and final rules 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) reflect the global nature of the security-based swap market and its development prior to the enactment of the Dodd-Frank Act.[15] We also noted our preliminary belief that dealing activity carried out by a non-U.S. person through a branch, office, affiliate, or an agent acting on its behalf in the United States may raise concerns that Title VII addresses, even if a significant proportion—or all—of those transactions involve non-U.S.-person counterparties.[16] We initially proposed to require any non-U.S. person engaged in dealing activity to include in its de minimis calculation any "transaction conducted within the United States." Thus, under the Cross-Border

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13 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 November 2014 (November 7, 2014), available at: http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/oia_odrgreportg20_1114.pdf.

14 Commission representatives participate in the Financial Stability Board's Working Group on OTC Derivatives Regulation ("ODWG"), both on the Commission's 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.

15 See Cross-Border Proposing Release, 78 FR 30975-76; Regulation SBSR Adopting Release, 80 FR 14724.

16 See Cross-Border Proposing Release, 78 FR 31000-01.

Proposing Release, a non-U.S. person engaged in dealing activity would have been required to include in its de minimis calculation any transaction where either the person itself or its counterparty performed relevant security-based swap activity within the United States.

The Cross-Border Proposing Release also included proposed rules regarding the application of the clearing, trade execution, regulatory reporting, and public dissemination requirements. Under the rules proposed in that release, the clearing requirement and the trade execution requirement also would have applied to a "transaction conducted within the United States," a transaction having a U.S.-person counterparty, or a transaction having a counterparty that is a non-U.S. person whose counterparty has a right of recourse against a U.S. person,[17] with certain exceptions.[18] The regulatory reporting requirement under that proposal would have applied to a "transaction conducted within the United States," a transaction in which either side of the security-based swap includes an indirect or direct U.S. person counterparty, a transaction in which a security-based swap dealer or major security-based swap participant is a direct or indirect counterparty to the security-based swap, or a transaction that is cleared through a clearing agency having its principal place of business in the United States.[19] The public dissemination requirement would have applied to a "transaction conducted within the United States," a transaction in which a U.S. person is a direct or indirect counterparty on each side of the security-based swap, a transaction in which at least one direct counterparty is a U.S. person (except in the case of a transaction conducted through a foreign branch), a transaction in which

17 In this release, we use the terms "non-U.S. persons whose counterparties have a right of recourse against a U.S. person under a security-based swap," "non-U.S. persons whose obligations under a security-based swap are guaranteed by a U.S. person," and "guaranteed non-U.S. persons" interchangeably.

18 See initially proposed Exchange Act rules 3Ca-3 and 3Ch-1.

19 See rule 908(a)(1), as re-proposed in the Cross-Border Proposing Release.

one side includes a U.S. person and the other side includes a non-U.S. person that is a security-based swap dealer, or a transaction cleared through a clearing agency having its principal place of business in the United States.[20]

D. The CFTC Staff Advisory

In November 2013, the CFTC's Division of Swap Dealer and Intermediary Oversight issued a Staff Advisory ("CFTC Staff Advisory") addressing the applicability of the CFTC's transaction-level requirements to certain activity by non-U.S. registered swap dealers arranged, negotiated, or executed by personnel or agents of the non-U.S. swap dealer located in the United States.[21] The CFTC Staff Advisory stated CFTC staff's belief that the CFTC "has a strong supervisory interest in swap dealing activities that occur within the United States, regardless of the status of the counterparties" and that a non-U.S. swap dealer "regularly using personnel or agents located in the U.S. to arrange, negotiate, or execute a swap with a non-U.S. person generally would be required to comply with" the CFTC's transaction-level requirements.[22] On January 8, 2014, the CFTC published a request for comment on various aspects of the CFTC Staff Advisory, including whether the CFTC "should adopt the Staff Advisory as Commission

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20 See rule 908(a)(2), as re-proposed in the Cross-Border Proposing Release.

21 See CFTC Staff Advisory No. 13-69, "Division of Swap Dealer and Intermediary Oversight Advisory: Applicability of Transaction-Level Requirements to Activity in the United States" (November 14, 2013), available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.

In the Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations (July 17, 2013), 78 FR 45292 (July 26, 2013) ("CFTC Cross-Border Guidance"), the CFTC defined transaction-level requirements to include the following: (i) required clearing and swap processing; (ii) margining (and segregation) for uncleared swaps; (iii) mandatory trade execution; (iv) swap trading relationship documentation; (v) portfolio reconciliation and compression; (vi) real-time public reporting; (vii) trade confirmation; (viii) daily trading records; and (ix) external business conduct standards. See CFTC Cross-Border Guidance, 78 FR 45333.

22 Id. at 2.

policy, in whole or in part."[23] In response to this request, the CFTC received approximately 20 comment letters addressing various aspects of the CFTC Staff Advisory.[24] CFTC staff subsequently extended no-action relief related to the CFTC Staff Advisory until the earlier of September 30, 2015, or the effective date of any CFTC action in response to the CFTC Request for Comment.[25] We understand that the CFTC Staff Advisory and comments received in response to the CFTC Request for Comment are under review at the CFTC.

E. Comments on the Proposed Definition of "Transaction Conducted within the United States" and Application of the Definition in the Cross-Border Proposing Release

A number of commenters on our Cross-Border Proposing Release addressed the definition of "transaction conducted within the United States." Although two commenters supported our proposed use of this defined term,[26] commenters generally criticized the proposed definition. These criticisms generally focused on four areas: the scope of activity potentially captured by the initially proposed defined term, the operational difficulties of implementing the defined term, the costs of implementation, and competitive concerns. Market participants also expressed a variety of views on the application of the regulatory reporting, public dissemination,

23 See Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States, 79 FR 1347 (January 8, 2014) ("CFTC Request for Comment").

24 The comment file is available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1452.

25 See Extension of No-Action Relief: Transaction-Level Requirements for Non-U.S. Swap Dealers, CFTC Letter No. 14-140 (November 14, 2014), available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-140.pdf.

26 See Letter from Citadel Letter to SEC, dated August 21, 2013 ("Citadel Letter") at 1-2; Letter from ABA to SEC, dated October 2, 2013 ("ABA Letter") at 3 (noting that the initially proposed conduct-based approach is consistent with longstanding Commission practice but also noting potential ambiguities). One of these commenters supported the initially proposed definition because it would help ensure that Title VII requirements applied to security-based swaps of offshore funds with a connection to the United States. See Citadel Letter at 1-2.

clearing, and trade execution requirements. Several market participants opposed the application of the requirements to "transaction[s] conducted within the United States" because of concerns about workability or the scope of the statute, while other commenters argued that the application of the requirements should be expanded to apply to any "transaction conducted within the United States."[27] In light of these comments and our understanding of the structure of the security-based swap market, we determined that our proposed treatment of "transactions conducted within the United States" would benefit from further consideration and solicitation of further comment.

II. Economic Considerations and Baseline Analysis

A. Broad Economic Considerations

These proposed amendments and re-proposed rule would determine when a non-U.S. person whose obligations under a security-based swap are not guaranteed by a U.S. person and that is not a conduit affiliate is required to include in its dealer de minimis calculation transactions with another non-U.S. person and when certain regulatory requirements apply to these and certain other transactions. To provide context for understanding our proposed rules and the related economic analysis that follows, this section discusses how this particular proposal fits within the Title VII framework and identifies broad economic considerations that we preliminarily believe underlie the proposal's likely economic effects.

[27] These comments are discussed in further detail below, in Sections III.B.2, IV.D, and V.C. As reflected in our discussion throughout this release, we have carefully considered both the CFTC Staff Advisory and the comments submitted in response to the CFTC's request for comment on the CFTC Staff Advisory in developing this proposal. Moreover, in connection with our statutory obligation to consult with the CFTC in connection with Title VII rulemaking, our staff have engaged in extensive discussion with CFTC staff regarding our proposed rules. We note, however, that our discussion of both the CFTC Staff Advisory and the comments received by the CFTC about it reflects our understanding of these documents. Accordingly, neither our discussions of these documents nor any preliminary views expressed herein should be interpreted as necessarily reflecting the views of any other agency or regulator, including the CFTC.

This analysis considers the effects of the proposed rules on security-based swap market participants and transactions that, as a result of these proposed rules, would be subject to rules that we have already adopted, or that we have proposed but not yet adopted, pursuant to Title VII. In particular, we consider the potential adverse effect on market participants of a security-based swap market that may remain opaque to regulators and market participants and that may lack robust customer protections.[28] We also consider possible competitive disparities arising under current and proposed rules.

Title VII provides a statutory framework for the OTC derivatives market and divides authority to regulate that market between the CFTC (which regulates swaps) and the Commission (which regulates security-based swaps). The Title VII framework requires certain market participants to register with the Commission as security-based swap dealers or major security-based swap participants and subjects such entities to certain requirements. The Title VII framework mandates that we establish rules that apply to certain security-based swap transactions, including mandatory clearing, mandatory trade execution, regulatory reporting, and public dissemination.

These proposed amendments and re-proposed rule, together with our previously adopted rules defining "security-based swap dealer" and "major security-based swap participant" and applying those definitions in the cross-border context, would define the scope of entities and transactions that are subject to the requirements of Title VII. Although these proposed amendments and re-proposed rule do not define the specific substantive requirements, the scope of application that they define will play a central role in determining the overall costs and

[28] See Section VI.B.2, infra, for further discussion of the economic effects of our proposed application of external business conduct requirements. See Section III.B.4, infra, for a discussion of how our proposed approach would support regulatory transparency.

benefits of particular regulatory requirements, and of the Title VII regulatory framework as a whole.[29] For example, to the extent that the proposed application of the de minimis exception leads to a higher number of registered security-based swap dealers, it is reasonable to expect that the aggregate costs and benefits associated with requirements applicable to such dealers will increase.[30]

Several broad economic considerations have informed our proposed approach to identify transactions between two non-U.S. persons that should be subject to certain Title VII requirements. First, to the extent that a financial group carries out security-based swap business in the United States, our ability to monitor dealers for market manipulation or other abusive practices may be limited, even with respect to a registered security-based swap dealer's security-based swaps with U.S. persons. For example, permitting a financial group to carry out a dealing business with U.S. persons through a registered security-based swap dealer and to hedge transactions arising out of that business in the inter-dealer market using the same personnel operating out of the same branch or office in the United States, but acting on behalf of an unregistered non-U.S.-person affiliate, would limit our ability to obtain records that would facilitate our ability to identify potentially abusive conduct in connection with the U.S. person's transactions with U.S.-person counterparties both within the security-based swap market as well as in markets for related underlying assets, such as corporate bonds. Moreover, a non-U.S. person engaged in dealing activity with non-U.S. persons in the United States but not subject to Regulation SBSR would not be required to report its trades, which could make it more difficult

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29 See Cross-Border Adopting Release, 79 FR 47327 (stating that the registration and regulation of entities as security-based swap dealers and major security-based swap participants will lead to programmatic costs and benefits).

30 See Section VI.B.1, infra.

for the Commission to monitor that activity for compliance with the federal securities laws and could reduce the transparency of prices in the security-based swap market in the United States. The proposed rules thus reflect our assessment of the impact that the scope of security-based swap transactions and security-based swap dealers subject to regulatory reporting and relevant security-based swap dealer requirements (such as external business conduct standards and recordkeeping and reporting requirements) may have on our ability to detect abusive and manipulative practices in the security-based swap market.

Second, in formulating these proposed rules, we have taken into account the potential impact that rules adopted as part of the Intermediary Definitions Adopting Release and the Cross-Border Adopting Release might have on competition between U.S. persons and non-U.S. persons when they engage in security-based swap transactions with non-U.S. persons, and the implications of these competitive frictions for market integrity. As noted in prior Commission releases, although the Dodd-Frank Act, including Title VII, seeks to achieve a number of benefits,[31] it also imposes costs on registered security-based swap dealers that unregistered persons are not required to bear.[32] For example, section 15F of the Exchange Act imposes various requirements on registered security-based swap dealers, including capital and margin requirements, recordkeeping and reporting requirements, and external business conduct requirements. While the Commission currently applies similar requirements to registered broker-dealers, Title VII applies these requirements only to persons that are registered as

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31 See Cross-Border Adopting Release, 79 FR 47280 n.11 (citing Dodd-Frank Act preamble, which states 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").

32 See id. at 47327.

security-based swap dealers. Under current Exchange Act rule 3a71-3(b)(1)(iii), adopted in the Cross-Border Adopting Release, a non-U.S. person that engages in more than a de minimis amount of dealing activity with non-U.S.-person counterparties using personnel located in the United States may face lower regulatory costs than a U.S. competitor engaging in identical activity, because the non-U.S. person is not required to include such transactions in its de minimis calculation. Competitive disparities may also arise as a result of differences in application of other Title VII requirements between U.S. persons and non-U.S. persons that are engaged in dealing activity using personnel located in the United States. As a result, such a non-U.S. person may be able to offer liquidity to its counterparties on more favorable terms than its U.S. competitors.

Under Exchange Act rule 3a71-3, non-U.S. persons may be able to subsidize their transactions with U.S. persons with profits from transactions with non-U.S. persons, allowing them to gain a competitive advantage with respect to transactions with U.S. persons from other dealing activity that is not subject to Title VII, even though it is carried out using personnel located in a U.S. branch or office. In the absence of the rules being proposed in this release, these competitive effects of disparate regulatory treatment may create an incentive for U.S. persons to use non-U.S.-person affiliates or non-U.S.-person agents that are located in the United States to engage in dealing activity with non-U.S.-person counterparties, because these non-U.S. persons could continue to deal with non-U.S.-person counterparties without being required to comply with any Title VII requirements.[33] This disparity could make transactions with U.S.-

[33] We note that, under Exchange Act rule 3a71-3, a non-U.S.-person affiliate of a U.S. person is not required to include such transactions in its dealer de minimis threshold calculations if that non-U.S. person's counterparties do not have recourse to a U.S. person under the terms of the security-based swap and the non-U.S. person is not a conduit affiliate. See Exchange Act rule

person dealers less attractive than transactions with non-U.S.-person dealers, even if the latter are arranging, negotiating, or executing the transaction using personnel located in a U.S. branch or office.

Moreover, differences in the application of the Title VII regulatory requirements may impose differing direct costs on different counterparties. For example, a non-U.S. person seeking to trade in a security-based swap on a U.S. reference entity may prefer to enter into the transaction with a non-U.S.-person dealer rather than a U.S.-person dealer. Even though both dealers are likely to arrange, negotiate, or execute a transaction on a U.S. reference entity using personnel located in a U.S. branch or office, the non-U.S.-person dealer may be more attractive because, for example, a transaction with that dealer may not involve a requirement to post collateral consistent with Title VII margin requirements or to comply with Regulation SBSR. The prospect of directly incurring the costs associated with compliance with Title VII requirements may cause these non-U.S. persons to prefer dealing with unregistered non-U.S.-person dealers, particularly if they can obtain the benefits associated with arranging, negotiating, or executing such a transaction using personnel located in a U.S. branch or office. The rules being proposed in this release are designed to mitigate this outcome.

Regulatory frictions arising from a difference in the treatment of dealing activity occurring in the United States could fragment security-based swap liquidity into two pools, one for U.S. persons and non-U.S. persons whose obligations under a security-based swap are guaranteed by a U.S. person, and the other for non-U.S. persons. Non-U.S. persons that arrange, negotiate, or execute transactions in connection with their dealing activity using personnel

3171-3(b)(1)(ii) and (iii) (applying the de minimis exception to cross-border dealing activity of conduit affiliates and non-U.S. persons).

located in a U.S. branch or office may, under current Exchange Act rule 3a71-3(b), seek to limit dealing activity with U.S. persons (for example, by quoting larger spreads to compensate for the expected costs of entity-level requirements) or may entirely refuse to supply liquidity to U.S. persons. This disparity in treatment may provide further incentives for U.S. persons to restructure their business to permit them to carry out their business with non-U.S. persons on similar terms.[34] This incentive may be particularly strong among U.S. dealers that are active in the inter-dealer market.

To the extent that the large inter-dealer market[35] shifts in significant part to non-U.S. dealers as a result of current rules, security-based swap activity in the United States could consist of one very large pool of transactions unregulated under Title VII (inter-dealer trades, and transactions between dealers and non-U.S. person non-dealers) and one much smaller pool limited to transactions between dealers and U.S.-person counterparties. This fragmentation could adversely affect the efficiency of risk sharing among security-based swap market participants, as discussed further in Sections VI.B.4(a) and VI.B.4(b), below.

Different treatment of transactions depending on whether they are arranged, negotiated, or executed by personnel located in a U.S. branch or office may create similar fragmentation among agents that may seek to provide services to foreign dealers. To the extent that using agents with personnel located in the United States results in substantial regulatory costs to foreign dealers, such foreign dealers may prefer and primarily use agents located outside the

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[34] See Section VI.B, infra, for further discussion of potential effects of the proposed rules on non-U.S. persons' incentives to use personnel located in U.S. branches or offices to arrange, negotiate, or execute security-based swap transactions.

[35] See Section II.B.2, infra, for an analysis of the proportion of the security-based swap market that constitutes inter-dealer transactions. For the purposes of this analysis we classify any security-based swap transaction between two ISDA-recognized dealers as inter-dealer activity.

United States, while U.S. dealers may continue to use agents located in the United States. This fragmentation of dealer and agent relationships, as in the case of liquidity fragmentation discussed earlier, may adversely affect the efficiency of risk sharing by security-based swap market participants.

B. Baseline

To assess the economic impact of the proposed amendments and rule 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 have not yet finalized.[36] The analysis includes the statutory provisions that currently govern the security-based swap market pursuant to the Dodd-Frank Act as well as rules adopted in the Intermediary Definitions Adopting Release, the Cross-Border Adopting Release, Regulation SBSR, and the Security-Based Swap Data Repository ("SDR") Rules and Core Principles.[37] Our understanding of the market is informed by available data on security-based swap transactions, though we acknowledge the data limit the extent to which we can quantitatively characterize the market. Because these data 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.

1. Current security-based swap market

Our analysis of the state of the current security-based swap market is based on data obtained from the DTCC Derivatives Repository Limited Trade Information Warehouse

[36] We also take into account, where appropriate, current industry practice in response to the actions of other regulators, such as the CFTC and the European Securities and Markets Authority.

[37] Exchange Act Release No. 74246 (February 11, 2015), 80 FR 14437 (March 19, 2015). 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.

("TIW"), especially data regarding the activity of market participants in the single-name credit default swap ("CDS") market during the period from 2008 to 2014. According to data published by the Bank for International Settlements ("BIS"), the global notional amount outstanding in equity forwards and swaps as of June 2014 was $2.43 trillion. The notional amount outstanding in single-name CDS was approximately $10.85 trillion, in multi-name index CDS was approximately $7.94 trillion, and in multi-name, non-index CDS was approximately $678 billion.[38] Our analysis in this release focuses on the data relating to single-name CDS. As we have previously noted, although the definition of "security-based swap" is not limited to single-name CDS, we believe that the single-name CDS transactions that we observe are sufficiently representative of the market and therefore can directly inform the analysis of the security-based swap market.[39]

We preliminarily believe that the data underlying our analysis here provide reasonably comprehensive information regarding single-name CDS transactions and the composition of the single-name CDS market participants. We note that the data available to us from TIW do not

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38 See Semi-annual OTC derivatives statistics at end-June 2014 (December 2014), Table 19, available at: http://www.bis.org/statistics/dt1920a.pdf.

39 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). In the Cross-Border Proposing Release, we explained that we believed that data related to single-name CDS was reasonable for purposes of this analysis, as such transactions appear to constitute roughly 82% of the security-based swap market as measured on a notional basis. See Cross-Border Proposing Release, 78 FR 31120 n.1301. 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.

Also consistent with our approach in that release, 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 as we do not currently have sufficient information to identify the relative volumes of index CDS that are swaps or security-based swaps.

encompass those CDS transactions that both: (i) do not involve U.S. counterparties;[40] and (ii) are based on non-U.S. reference entities. Notwithstanding this limitation, we preliminarily believe that the 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.[41]

(a) Dealing Structures and Participant Domiciles

Dealers occupy a central role in the security based swap market and security-based swap dealers use a variety of business models and legal structures to engage in dealing activity with counterparties in jurisdictions all around the world.[42] As we noted in the Cross-Border Adopting Release and as discussed below in Section III.B.4(a), both U.S.-based and foreign-based entities use certain dealing structures for a variety of legal, tax, strategic, and business reasons.[43] Dealers

40 We note that TIW's entity domicile determinations may not reflect our definition of "U.S. person" in all cases.

41 The challenges we face in estimating measures of current market activity stem, in part, from the absence of comprehensive reporting requirements for security-based swap market participants. We have adopted rules regarding trade reporting, data elements, and public reporting for security-based swaps that will, when fully implemented, provide us with appropriate measures of market activity. See Regulation SBSR Adopting Release, 80 FR 14699-700.

42 Commission staff analysis of TIW transaction records indicates that approximately 99% of single-name CDS price-forming transactions in 2014 involved an ISDA-recognized dealer. "Price-forming transactions" include all new transactions, assignments, 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. See Cross-Border Proposing Release, 78 FR 31121 n.1312. For the purpose of this analysis, the ISDA-recognized dealers are those identified by ISDA as belonging to the dealer group, including JP Morgan Chase, Morgan Stanley, Bank of America, Goldman Sachs, Deutsche Bank, Barclays, Citigroup, UBS, Credit Suisse, RBS Group, BNP Paribas, HSBC, Société Générale, Credit Agricole, Wells Fargo, and Nomura. See, e.g., http://www2.isda.org/functional-areas/research/surveys/operations-benchmarking-surveys/.

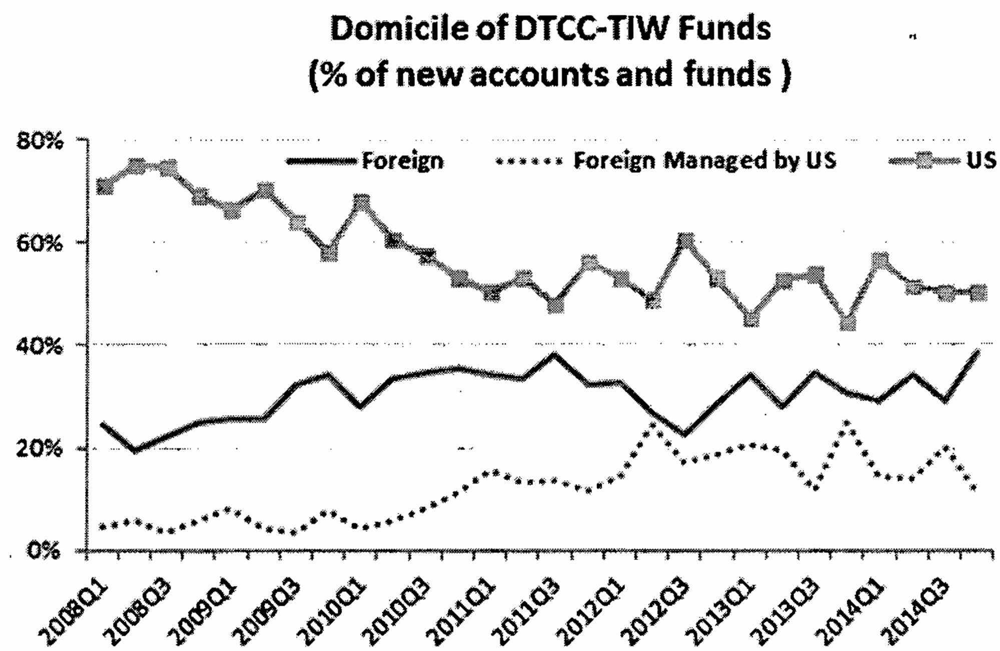
43 See Cross-Border Adopting Release, 79 FR 30976.

may use a variety of structures in 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. A U.S.-based holding company may engage in dealing activity through a foreign subsidiary that faces both U.S. and foreign counterparties, and foreign dealers may choose to deal with U.S. and foreign counterparties through U.S. subsidiaries. Similarly, a non-dealer user of security-based swaps may participate in the market using an agent in its 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.

In some situations, an entity's performance under security-based swaps may be supported by a guarantee provided by an affiliate. Such a guarantee 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 a 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.

Figure 1: The percentage of (1) new accounts with a domicile in the United States (referred to as "US"), (2) new accounts with a domicile outside the United States (referred to below as "Foreign"), and (3) new accounts outside the United States but managed by a U.S. person, account of a foreign branch of a U.S. person, and accounts of a foreign subsidiary of a U.S. person (collectively referred to below as "Foreign Managed by US").[44] Unique, new accounts are aggregated each quarter and percentages are computed on a quarterly basis, from January 2008 through December 2014.



As depicted in Figure 1, the domicile of new accounts participating in the market has shifted 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

44 Following publication of the Warehouse Trust Guidance on CDS data access, 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 TIW. When an account does not report a registered office location, we have assumed that the settlement country reported by the investment adviser or parent entity to the fund or account is the place of domicile. This treatment assumes that the registered office location reflects the place of domicile for the fund or account.

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. Alternatively, the shifts in new account domicile that we observe in Figure 1 may be unrelated to restructuring or increased foreign participation. For example, changes in the domicile of new accounts over time may reflect improvements in reporting by market participants to TIW rather than a change in market participant structure.[45] Additionally, because the data include only accounts that are domiciled in the United States, that transact with U.S.-domiciled counterparties, or that 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.-person counterparties or increased transactions in single-name CDS on U.S. reference entities by foreign persons.

(b) Market Centers

Participants in the security-based swap market may bear the financial risk of a security-based swap transaction in a location different from the location where the transaction is arranged, negotiated, or executed or the location where economic decisions are made by managers on behalf of beneficial owners. Similarly, a participant in the security-based swap market may be exposed to counterparty risk from a jurisdiction that is different from the market center or centers in which it primarily operates. These participants appear to be active in market centers across the globe.

The TIW transaction records include, in many cases, information on particular branches involved in transactions, which may provide limited insight as to where security-based swap

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45 See note 44, supra.

activity is actually being carried out.[46] These data indicate branch locations located in New York, London, Tokyo, Hong Kong, Chicago, Sydney, Toronto, Frankfurt, Singapore, and the Cayman Islands. Because transaction records in the TIW data provided to us do not indicate explicitly the location in which particular transactions were arranged, negotiated, or executed, these locations may not represent the full set of locations in which activities relevant for these proposed rules take place. Moreover, because we cannot identify the location of transactions within TIW, we are unable to estimate the general distribution of transaction volume across market centers.

(c) Current Estimates of Number of Dealers

In the Regulation SBSR Adopting Release, we estimated, based on an analysis of TIW data, that out of more than 4,000 entities engaged in single-name CDS activity worldwide in 2013, 170 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.[47] Approximately 45 of these entities are non-U.S. persons and are expected to incur assessment costs as a result of engaging in dealing activity with counterparties that are U.S. persons or engaging in dealing activity that involves recourse to U.S. persons.[48] Analysis of those data further indicated that potentially 50 entities may engage in dealing activity

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46 The value of this information is limited in part because some market participants may use business models that do not involve branches to carry out business in jurisdictions other than their home jurisdiction. For example, some market participants may use affiliated or unaffiliated agents to enter into security-based swap transactions in other jurisdictions on their behalf. The available data currently does not allow us to identify with certainty which type of structure is being used in any particular transaction.

47 See Regulation SBSR Adopting Release, 80 FR 14693.

48 See Exchange Act rule 3a71-3(b).

that would exceed the de minimis threshold and thus ultimately have to register as security-based swap dealers.[49]

Updated analysis of 2014 data leaves many of these estimates largely unchanged. We estimate that approximately 170 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. Approximately 56 of these entities are non-U.S. persons. Of the approximately 50 entities that we estimate may potentially register as security-based swap dealers, we preliminarily believe it is reasonable to expect 22 to be non-U.S. persons.

2. Levels of security-based swap trading activity

Single-name CDS contracts make up the vast majority of security-based swaps, and most are written on corporate issuers, corporate securities, sovereign countries, or sovereign debt (reference entities or securities). Figure 2 below describes the percentage of global, notional transaction volume in North American corporate single-name CDS reported to the TIW between January 2008 and December 2013, separated by whether transactions are between two ISDA-recognized dealers (inter-dealer transactions) or whether a transaction has at least one non-dealer counterparty.

Annual trading activity with respect to North American corporate single-name CDS in terms of notional volume has declined from more than \$6 trillion in 2008 to less than \$3 trillion in 2014.[50] While notional volume has declined over the past six years, the portion of the notional

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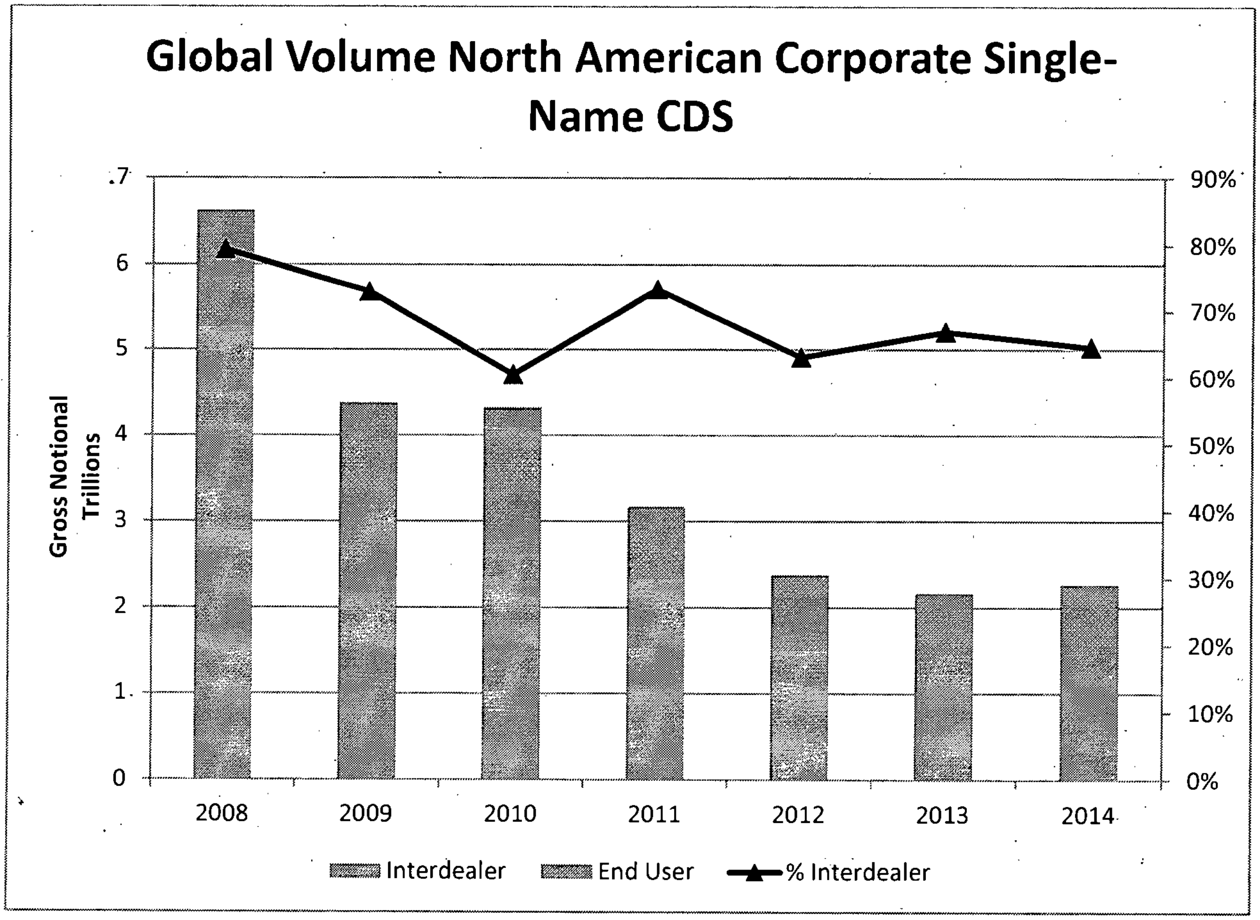
49 See Regulation SBSR Adopting Release, 80 FR 14693.

50 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 legislation and the development of security-based swap market regulation.

volume represented by inter-dealer transactions has remained fairly constant and inter-dealer transactions continue to represent a significant majority of trading activity, whether measured in terms of notional value or number of transactions (see Figure 2).

The high level of inter-dealer trading activity reflects the central position of a small number of dealers, each of which intermediates trades between many hundreds of counterparties. While we are unable to quantify the current level of trading costs for single-name CDS, those dealers appear to enjoy market power as a result of their small number and the large proportion of order flow they privately observe. This market power in turn appears to be a key determinant of trading costs in this market.

Figure 2: Global, notional trading volume in North American corporate single-name CDS by calendar year and the fraction of volume that is inter-dealer.



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 set of data that 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 TIW accounts, we estimate that only 12% of the global transaction volume by notional volume between 2008 and 2014 was between two U.S.-domiciled counterparties, compared to 48% entered into between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 40% entered into between two foreign-domiciled counterparties (see Figure 3).[51]

When the domicile of TIW accounts is instead defined according to the domicile of an account's ultimate parents, headquarters, or home office (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 32%, and to 51% 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 40% to 17% when domicile is defined as the ultimate parent's domicile. As noted earlier, foreign subsidiaries of U.S. parent companies and foreign branches of U.S. banks, and U.S. subsidiaries of foreign parent companies and U.S.

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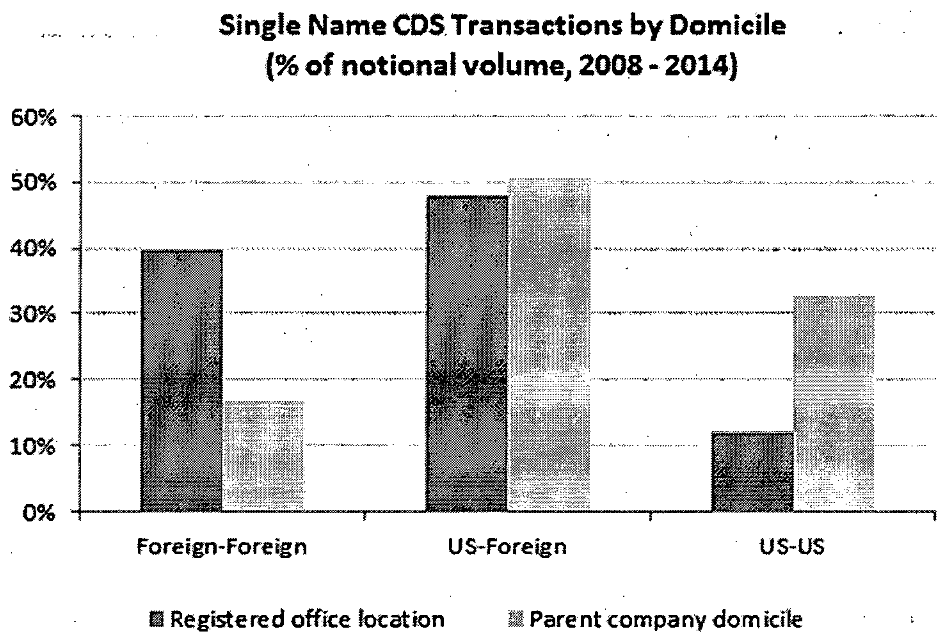
[51] See note 44, supra. For purposes of this discussion, we have assumed that the registered office location reflects the place of domicile for the fund or account, but we note that this domicile does not necessarily correspond to the location of an entity's sales or trading desk.

branches of foreign banks may transact with U.S. and foreign counterparties. However, this change in respective shares based on different classifications 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.

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 2014.



3. Regulatory reporting, clearing, and trade execution of security-based swap transactions

We have adopted final rules implementing regulatory reporting requirements for security-based swap transactions, although compliance with most aspects of this regime is not yet required.[52] Although counterparties are not yet required to comply with rules that require them to report transaction information, virtually all market participants voluntarily report their trades

[52] See Regulation SBSR Adopting Release, 80 FR 14566.

in single-name CDS to TIW, which maintains a record of these transactions, in some cases with the assistance of post-trade processors.[53] Among other things, this centralized record-keeping facilitates settlement of obligations between counterparties when a default event occurs as well as bulk transfers of positions between accounts at a single firm or between firms.

Clearing of security-based swaps, which is currently voluntary in the United States, is currently limited to CDS products, and a substantial proportion of single-name CDS accepted for clearing are already being cleared. Prior to the Dodd-Frank Act, ICE Clear Credit and ICE Clear Europe engaged in CDS clearing activities pursuant to exemptive orders issued by the Commission.[54] Pursuant to the Dodd-Frank Act, ICE Clear Credit and ICE Clear Europe were deemed to be registered with the Commission in July 2011 as clearing agencies for security-based swaps.[55] ICE Clear Credit began clearing corporate single-name CDS in December 2009,[56] and, as of March 17, 2015, had cleared a total of $3.06 trillion gross notional of single-

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53 See http://www.isdacdsmarketplace.com/exposures_and_activity (last visited September 22, 2014).

54 See, e.g., Exchange Act Release No. 59527 (March 6, 2009), 74 FR 10791 (March 12, 2009) ("ICE Clear Credit Exemptive Order"); Exchange Act Release No. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009) ("ICE Clear Europe Exemptive Order"). In connection with those orders, Commission considered clearing practices of those central counterparties ("CCPs"), including, inter alia, their risk management methodologies.

55 Section 17A(l) of the Exchange Act provides in relevant part that a derivative clearing organization registered with the CFTC that clears security-based swaps would be deemed to be registered as a clearing agency under section 17A if, prior to the enactment of the Dodd-Frank Act, it cleared swaps pursuant to an exemption from registration as a clearing agency. Both ICE Clear Credit and ICE Clear Europe also are registered with the CFTC as derivative clearing organizations.

56 See Exchange Act Release No. 61662 (March 5, 2010), 75 FR 11589, 11591 (March 11, 2010) (discussing ICE Clear Credit's CDS clearing activities as of March 2010).

ICE Clear Credit (then known as ICE US Trust LLC) began clearing index CDS in March 2009. See Exchange Act Release No. 59527 (March. 6, 2009), 74 FR 10791 (March 12, 2009) (order granting temporary exemptions under the Exchange Act on behalf of ICE US Trust LLC).

name CDS on 368 North American and European instruments.[57] As of the beginning of this year, ICE Clear Credit accepted for clearing a total of 207 CDS products based on North American instruments, 168 CDS products based on European instruments, and fifteen CDS products based on individual sovereign (nation-state) reference entities.

Staff analysis of trade activity from July 2012 to December 2013 indicate that, out of \$938 billion of notional traded in North American corporate single-name CDS contracts that have reference entities that are accepted for clearing during the 18 months ending December 2013, approximately 71%, or \$666 billion, had characteristics making them suitable for clearing by ICE Clear Credit and represented trades between two ICE Clear Credit clearing members. Approximately 79% of this notional value, or \$525 billion, was cleared through ICE Clear Credit, or 56% of the \$938 billion in new trade activity.

Figure 4 shows the proportion of new trades and assign-entries defined as clearable at ICE Clear Credit that were ultimately cleared.[58]

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57 ICE Clear Credit also has cleared a total of \$37.3 trillion gross notional on 137 index CDS as of March 20, 2015. See ICE Clear Credit, Volume of ICE CDS Clearing, available at: https://www.theice.com/clear_credit.jhtml.

In addition to clearing single-name CDS on North American corporate reference entities, ICE Clear Credit also clears CDS on certain non-U.S. sovereign entities, and on certain indices based on North American reference entities.

58 For the purposes of this analysis, "clearable" describes CDS contracts on North American single-name corporate reference entities between clearing members that reference the ISDA Standard North American Corporate (SNAC) documentation, are denominated in U.S. dollars, do not include restructuring as a credit event and have a standard coupon. If ICE Clear Credit accepts CDS on the reference entity for clearing, then a standard coupon is one that is accepted for clearing for that reference entity by ICE Clear Credit; otherwise, standard coupon means a coupon of either 100 or 500 basis points. See SEC Division of Economic and Risk Analysis, Single-Name Corporate Credit Default Swaps: Background Data Analysis on Voluntary Clearing Activity, 15 (April 2015), available at http://www.sec.gov/dera/staff-papers/white-papers/voluntary-clearing-activity.pdf.

Evidence from the TIW data suggests that even single-name CDS written on reference entities that were initially accepted for clearing by ICE Clear Credit were traded infrequently. Figure 5 plots of the daily mean number of transactions per trading day for each of the 538 North American single-name corporate reference entities with at least one transaction per month on average during the period from January 2011 to December 2013.[59] Each vertical bar represents the mean number of transactions per day for a reference entity.[60] The 538 reference entities are presented in decreasing order of the mean number of transactions per trading day. Commission staff has identified the 68 reference entities in the sample that were cleared by ICE Clear Credit prior to the enactment of the Dodd-Frank Act (the "deemed submitted" reference entities). The 68 deemed submitted reference entities are marked by Xs forming a line near the horizontal axis. The remaining Xs (those not on the line of Xs near the horizontal axis) represent, for each reference entity, the fraction of days with no transactions. The evidence in Figure 5 suggests that within the sample period, the most traded entity of the 68 "deemed submitted" reference entities was traded approximately 15 times per day on average. Despite the low average number of transactions per day, these 68 reference entities generally have a lower proportion of days with no transactions relative to the rest of the single-name CDS market represented in the sample.

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59 We analyze single-name corporate reference entities with at least one transaction per month on average from January 2011 to December 2013 to avoid including outliers that trade extremely infrequently. Of the 573 North American single-name corporate reference entities with at least 36 transactions included in Figure 5, only 538 had at least 36 new trades, implying that the other 35 had price forming transactions that were not associated with new trading activity, such as terminations or assignments. See id. at 41.

60 Transaction types include all price forming transactions: new trades, amendments that change economic terms of the contract, assignments, and terminations.

ICE Clear Europe began clearing CDS on single-name corporate reference entities in December 2009,[61] and, as of March 17, 2015, had cleared a total €2.48 trillion in gross notional of single-name CDS on 161 European corporate reference entities.[62] As of the beginning of 2015, ICE Clear Europe accepted for clearing a total of 161 CDS products based on European corporate reference entities.

Staff analysis of new trade activity from July 2012 to December 2013 indicate that out of €531 billion of notional traded in European corporate single-name CDS contracts that have reference entities that are accepted for clearing during the 18 months ending December 2013, approximately 70%, or €372 billion had characteristics making them suitable for clearing by ICE Clear Europe and represented trades between two ICE Clear Europe clearing members. Approximately 51% of this notional value, or €191 billion was cleared through ICE Clear Europe, representing 36% of the total volume of new trade activity.[63]

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61 See Exchange Act Release No. 61973 (April 23, 2010), 75 FR 22656, 22657 (April 29, 2010) (discussing ICE Clear Europe's CDS clearing activity as of April 2010).

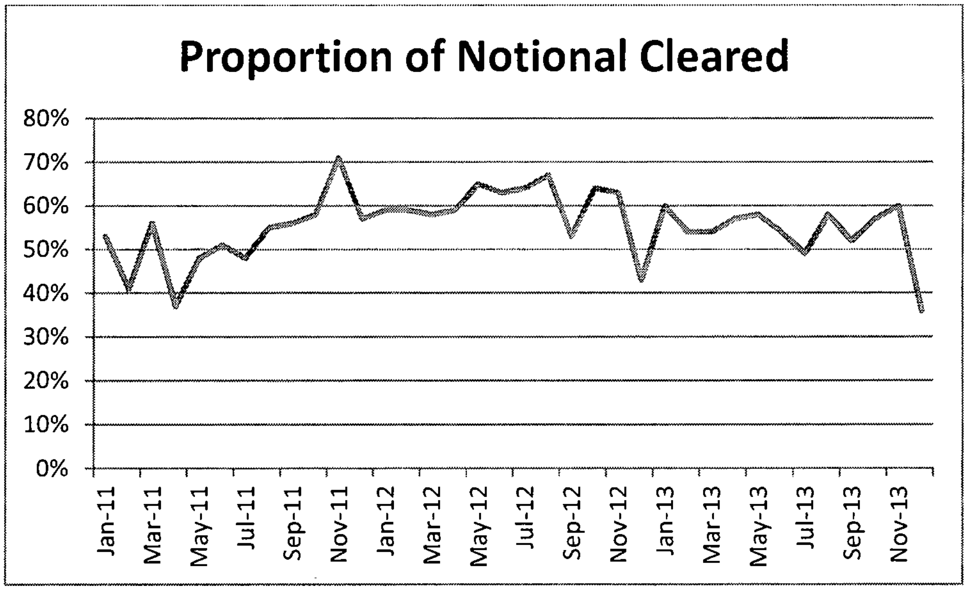
ICE Clear Europe commenced clearing index CDS in July 2009. See Exchange Act Release No. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009) (order granting temporary exemptions under the Exchange Act on behalf of ICE Clear Europe).

62 ICE Clear Europe also has cleared a total of €14.4 trillion in gross notional on 64 index CDS as of March 20, 2015. See ICE Clear Europe, Volume of ICE CDS Clearing, available at: https://www.theice.com/clear_credit.jhtml.

Aside from clearing single-name CDS on European corporate reference entities, ICE Clear Europe also clears CDS on indices based on European reference entities, as well as futures and instruments on OTC energy and emissions markets.

63 These numbers do not include transactions in European corporate single-name CDS that were cleared by ICE Clear Credit. However, during the sample period, there was only one day on which there were transactions that were cleared by ICE Clear Credit (December 20, 2013) and the traded notional of these transactions was minimal. For historical data, see https://www.theice.com/marketdata/reports/99.

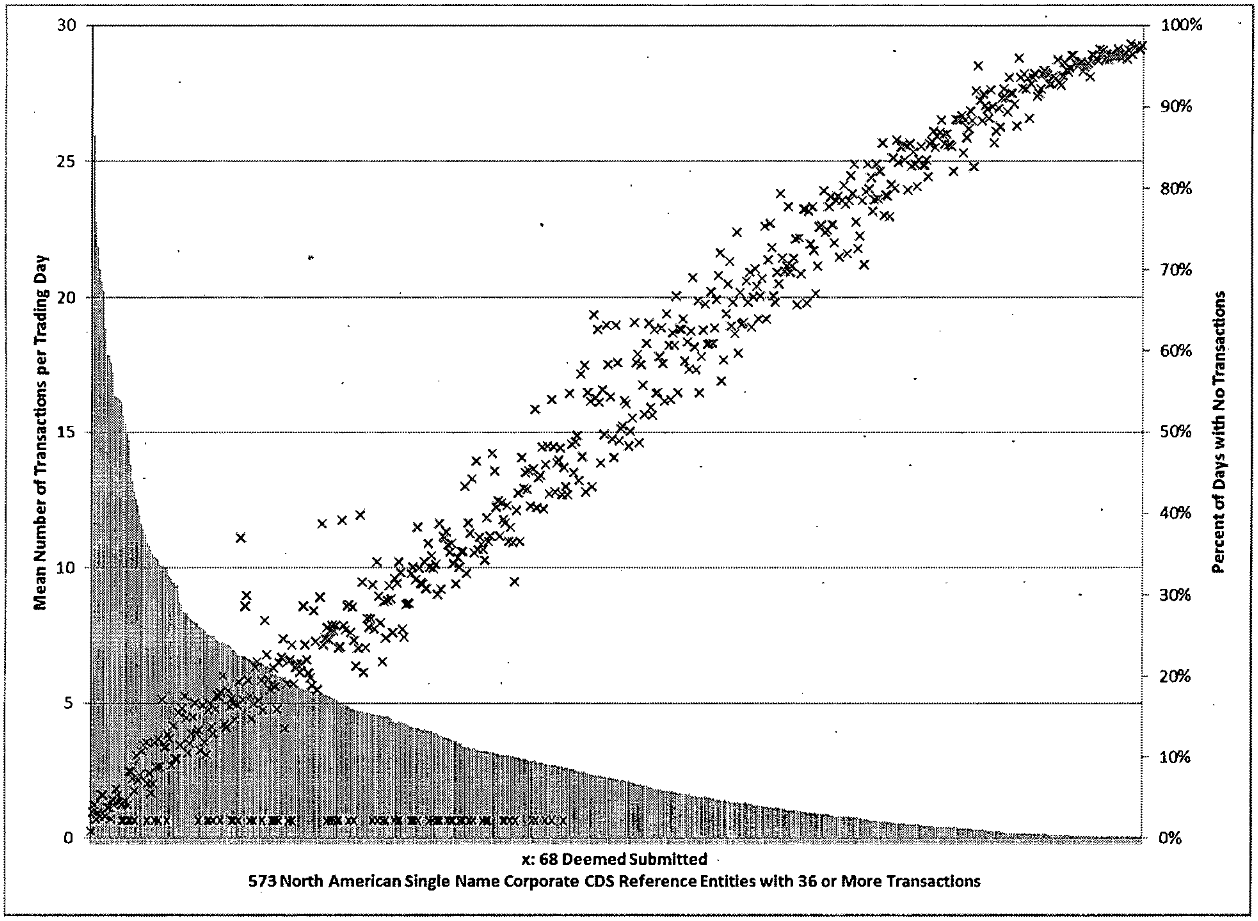
Figure 4: The fraction of total gross notional amount of new trades and assign-entries in North American single-name CDS products that was clearable at ICE Clear Credit, and was cleared within 14 days of the initial transaction.[64]



64 We preliminarily believe that it is reasonable to assume that, when clearing occurs within 14 days of execution, counterparties made the decision to clear at the time of execution and not as a result of information arriving after execution.

An "assign-entry" involves the substitution of one of the contract counterparties in an existing instrument for a new counterparty in exchange for cash consideration. It is economically equivalent to a termination of the initial contract between the "old" counterparty and the "static" counterparty and a new trade between the "replacement" counterparty and the "static" counterparty.

Figure 5. North American Single-Name Corporate CDS Transaction Activity: January 2011–December 2013



Unlike the markets for cash equity securities and listed options, the market for security-based swaps is characterized almost exclusively by bilateral OTC negotiation and is largely decentralized.[65] The lack of uniform rules concerning the trading of security-based swaps and the historical one-to-one nature of trade negotiation in security-based swaps has resulted in the formation of distinct types of trading venues and execution practices, ranging from bilateral negotiations carried out over the telephone,[66] single-dealer RFQ platforms,[67] multi-dealer RFQ

65 See SB SEF Proposing Release, 76 FR 10951.

66 "Bilateral negotiation" refers to the execution practice whereby one party uses telephone, e-mail, or other communication methods to contact directly a potential counterparty to negotiate and

platforms,[68] central limit order books,[69] and brokerage trading.[70] These various trading venues and execution practices provide different degrees of pre-trade transparency and afford market participants different levels of access. We currently do not have sufficient information with respect to the volume of security-based swap transactions executed across these different trading venues and using these various execution practices.

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execute a security-based swap. The bilateral negotiation and execution practice provides no pre-trade or post-trade transparency because only the two parties to the transaction are aware of the terms of the negotiation and the final terms of the agreement. See SB SEF Proposing Release, 76 FR 10951.

67 A single-dealer RFQ platform refers to an electronic trading platform where a dealer may post indicative quotes for security-based swaps in various asset classes that the dealer is willing to trade. Only the dealer's approved customers would have access to the platform. When a customer wishes to transact in a security-based swap, the customer requests an executable quote, the dealer provides one, and if the customer accepts the dealer's quote, the transaction is executed electronically. This type of platform generally provides pre-trade transparency in the form of indicative quotes on a pricing screen, but only from one dealer to its customer. See SB SEF Proposing Release, 76 FR 10951.

68 A multi-dealer RFQ electronic trading platform refers to a multi-dealer RFQ system whereby a requester can send an RFQ to solicit quotes on a certain security-based swap from multiple dealers at the same time. After the RFQ is submitted, the recipients have a prescribed amount of time in which to respond to the RFQ with a quote. Responses to the RFQ are firm. The requestor then has the opportunity to review the responses and accept the best quote. A multi-dealer RFQ platform provides a certain degree of pre-trade transparency, depending on its characteristics. See SB SEF Proposing Release, 76 FR 10952.

69 A limit order book system or similar system refers to a trading system in which firm bids and offers are posted for all participants to see, with the identity of the parties withheld until a transaction occurs. Bids and offers are then matched based on price-time priority or other established parameters and trades are executed accordingly. The quotes on a limit order book system are firm. In general, a limit order book system provides greater pre-trade transparency than the three models described above because all participants can view bids and offers before placing their bids and offers. See SB SEF Proposing Release, 76 FR 10952. Currently, limit order books for the trading of security-based swaps in the United States are utilized by inter-dealer brokers for dealer-to-dealer transactions.

70 "Brokerage trading" refers to an execution practice used by brokers to execute security-based swaps on behalf of customers, often in larger-sized or bespoke transactions. In such a system, a broker receives a request from a customer (which may be a dealer) that seeks to execute a specific type of security-based swap. The broker then interacts with other customers to fill the request and execute the transaction. This model often is used by dealers that seek to transact with other dealers through the use of an inter-dealer broker as an intermediary. In this model, there may be pre-trade transparency to the extent that participants are able to see bids and offers of other participants. See SB SEF Proposing Release, 76 FR 10952.

We have proposed, but have not yet adopted, rules establishing a registration regime and core principles for security-based swap execution facilities ("SB SEFs"). We have not proposed to implement the mandatory trade execution requirement contained in section 3C(h) of the Exchange Act. Currently, there are no SB SEFs registered with the Commission, and as a result, there is no registered SB SEF trading activity to report. There are, however, currently 25 trading platforms that either are temporarily registered with the CFTC as SEFs or have SEF temporary registration applications pending with the CFTC and currently are exempt from registration with the Commission.[71] As we discuss in Section II.B.5, the cash flows of security-based swaps and swaps are closely related and many participants in the security-based swap also participate in the swap market and so we preliminarily believe that many SEFs that currently serve as trading venues for swaps are likely also to register with the Commission as SB SEFs. However, owing to the smaller size of the security-based swap market, we currently expect that there will be fewer exchanges and SB SEFs that will eventually host transactions in security-based swaps than the 25 SEFs reported within the CFTC's jurisdiction.

4. Global regulatory efforts

Efforts to regulate the swaps market are underway not only in the United States but also abroad, and these efforts have received significant attention in international fora. For example, in 2009, leaders of the G20—whose membership includes the United States, 18 other countries, and the EU—addressed global improvements in the functioning, transparency, and regulatory

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71 See Effective Date Release, 76 FR at 36306 (exempting persons that operate a facility for the trading or processing of security-based swaps that is not currently registered as a national securities exchange, or that cannot yet register as an SB SEF because final rules for such registration have not yet been adopted, from the requirements of Section 3D(a)(1) of the Exchange Act until the earliest compliance date set forth in any of the final rules regarding registration of SB SEFs). A list of platforms that either are temporarily registered with the CFTC or have SEF temporary registration applications pending with the CFTC is available at: http://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=SwapExecutionFacilities (last visited March 2, 2015).

oversight of OTC derivatives markets. They expressed their view on a variety of issues relating to OTC derivatives contracts, including trading on exchanges or electronic trading platforms, clearing through CCPs, and reporting to trade repositories.[72] In subsequent summits, the G20 leaders have returned to OTC derivatives regulatory reform and encouraged international consultation in developing standards for these markets.[73]

Jurisdictions with major OTC derivatives markets have taken steps toward substantive regulation of these markets, though the pace of regulation varies. Accordingly, many foreign participants likely will be required to comply with substantive regulation of their security-based swap activities apart from regulations that may apply to them pursuant to Title VII. The concerns foreign jurisdictions seek to address with their regulations may overlap or be similar to those addressed by the Title VII regulatory framework.

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. The first two areas of regulation should help improve transparency in OTC derivatives markets, both to regulators and market participants. Regulatory transaction reporting requirements are mandated in a number of jurisdictions including the EU, Hong Kong SAR, Japan, and Singapore; other jurisdictions are in the process of proposing legislation and

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72 See G20 Leaders' Statement, Pittsburgh, United States, September 24-25, 2009, available at: http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

73 See the G20 Leaders Communique (November 2014), para. 12, available at: https://www.g20.org/sites/default/files/g20_resources/library/brisbane_g20_leaders_summit_communique.pdf.

rules to implement these requirements.[74] The EU has adopted legislation for markets in financial instruments that addresses trading OTC derivatives on regulated trading platforms.[75] This legislation also should promote post-trade public transparency in OTC derivatives markets by requiring the price, volume, and time of derivatives transactions conducted on these regulated trading platforms to be made public in as close to real time as technically possible.[76]

Regulation of derivatives central clearing, capital requirements, and margin requirements aims, among other things, to improve management of financial risks in these markets.[77] Japan has rules in force mandating central clearing of certain OTC derivatives transactions.[78] 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. A number of major foreign jurisdictions have initiated the process of drafting rules to implement margin requirements for OTC derivatives transactions.

5. 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

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74 Information regarding ongoing regulatory developments described in this section was primarily obtained from progress reports published by the Financial Stability Board. These are available at: http://www.financialstabilityboard.org/list/ fsb_publications/index.htm.

75 See id.

76 See Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) no 648/2012), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014R0600&from=EN.

77 See note 74, supra.

78 See id.

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.[79] Available data suggest that these numbers remain largely unchanged.[80]

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. 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. 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 single-name CDS and index CDS contracts, prices of these products depend upon one another,[81] creating hedging opportunities across these markets.

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79 See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 65543 (October 12, 2011), 76 FR 65784, 65808 (October 24, 2011).

80 Based on its analysis of 2014 TIW data and the list of swap dealers provisionally-registered with the CFTC, and applying the methodology used in the Intermediary Definitions Adopting Release, we estimate 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.

81 "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.

These hedging opportunities mean that participants that are active in one market are likely to be active in the other. Commission staff analysis of approximately 4,500 TIW accounts that participated in the market for single-name CDS in 2014 revealed that approximately 2,500 of those accounts, or 56%, also participated in the market for index CDS. Of the accounts that participated in both markets, data regarding transactions in 2014 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 60%; 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 11%.

As discussed in more detail below,[82] the CFTC Staff Advisory issued in November 2013 stated the CFTC staff's belief that the CFTC has a strong supervisory interest in swap dealing activities that occur within the United States, regardless of the status of the counterparties. The CFTC Staff Advisory, which we understand to be under review at the CFTC,[83] also stated the CFTC staff's belief that a non-U.S. swap dealer "regularly using personnel or agents located in the U.S. to arrange, negotiate, or execute a swap with a non-U.S. person generally would be required to comply with" the CFTC's transaction-level requirements.[84] While CFTC staff has granted relief from certain aspects of the CFTC Staff Advisory,[85] at least one commenter has argued that the CFTC's approach to regulation of swap dealers taken in the CFTC Cross-Border Guidance has influenced the information that market participants collect and maintain about the

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[82] See Section III.B.3, infra.

[83] See CFTC Request for Comment.

[84] See CFTC Staff Advisory at 1-2.

[85] See note 25, supra.

swap transactions they enter into and the counterparties they face.[86] Although that commenter suggested that swap market participants have also adopted business practices consistent with the CFTC Cross-Border Guidance, the commenter did not supply particular details as to the scope of the changes to its operations.[87]

The proposed amendments and proposed rule may, to the extent that they are not in conflict with the approach taken in the CFTC Cross-Border Guidance, permit non-U.S. persons to use infrastructures developed to be consistent with the CFTC's approach, to comply with Commission requirements as well. Among those entities that participate in both markets, entities that are able to apply to security-based swap activity capabilities that are consistent with the CFTC Cross-Border Guidance 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. We remain sensitive to the fact that in cases where our final rules differ from the CFTC approach, additional outlays related to information collection and storage may be required.

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86 See, e.g., Letter from Securities Industry and Financial Markets Association/Futures Industry Association/Financial Services Roundtable ("SIFMA/FIA/FSR") to SEC, dated August 21, 2013 ("SIFMA/FIA/FSR Letter") at 2-3.

87 Id. at 2-4. The commenter notes the "technological, operational, legal and compliance systems" necessary for complying with our proposed rules, and taking account of the CFTC Cross-Border Guidance, outlining the general categories of changes to practice necessary for compliance. Id. 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 adopted market practices consistent with the CFTC Cross-Border Guidance. Id.

III. Application of the Dealer De Minimis Exception to U.S. Security-Based Swap Dealing Operations of Non-U.S. Persons

A. Overview

The Exchange Act excepts from designation as a "security-based swap dealer" an entity that engages in a "de minimis" quantity of security-based swap dealing activity with or on behalf of customers.[88] Under the final rules adopted in the Intermediary Definitions Adopting Release, a person may take advantage of that exception if, in connection with credit default swaps 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.[89] 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"—we either terminate the phase-in period or establish an alternative threshold following rulemaking.[90]

The Cross-Border Adopting Release finalized rules specifying, among other things, when a non-U.S. person is required to include transactions arising from its dealing activity in its de minimis threshold calculations.[91] These final rules addressed the application of the security-based swap dealer de minimis exception to such person's dealing activity involving U.S.-person

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88 See Exchange Act section 3(a)(71)(D).

89 See Exchange Act rule 3a71-2(a)(1)(i). 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).

90 See Intermediary Definitions Adopting Release, 77 FR 30640-41. Exchange Act rule 3a71-2 establishes 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. In that release we explained that at the end of the phase-in period, we 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 id. at 30640.

91 See Cross-Border Adopting Release, 79 FR 47319-322. See also Exchange Act rules 3a71-3(b), 3a71-4.

counterparties, as well as the dealing activity of a non-U.S. person that is a conduit affiliate[92] or whose counterparty has a right of recourse under the security-based swap against an affiliated U.S. person.[93] Although we had proposed requiring a non-U.S. person to include in this calculation any dealing activity involving another non-U.S.-person counterparty if it resulted in a "transaction conducted within the United States" as defined in the proposed rule,[94] we did not address this issue in our Cross-Border Adopting Release. As we noted in that adopting release, commenters raised a number of significant issues related to this element of the Cross-Border Proposing Release, including our authority to impose, and the costs of complying with, this requirement, and we determined that final resolution of this issue would benefit from further consideration and public comment.[95]

In light of those comments and further consideration of the concerns raised by such transactions and subsequent regulatory and market developments, the statutory objectives, and the practicability of our initially proposed approach, we have determined to propose an amendment to Exchange Act rules 3a71-3 and 3a71-5 that more closely focuses on certain dealing activity carried out, at least in part, by personnel located in the United States.[96] The proposed amendments would not require a non-U.S. person engaging in dealing activity to consider the location of its non-U.S.-person counterparty or that counterparty's agent in determining whether the transaction needs to be included in its own de minimis calculation. Instead, the proposed amendments would require a non-U.S. person to include in its de minimis

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92 See Exchange Act rule 3a71-3(a)(1); Cross-Border Adopting Release, 79 FR 47313.

93 See Cross-Border Adopting Release, 79 FR 47316.

94 See Cross-Border Proposing Release, 78 FR 30999-31001.

95 See, e.g., Cross-Border Adopting Release, 79 FR 47280.

96 See proposed Exchange Act rule 3a71-3(b)(1)(iii)(C); proposed Exchange Act rule 3a71-5(c).

calculation any transaction connected with its security-based swap dealing activity that it enters into with a non-U.S.-person counterparty only when the transaction is arranged, negotiated, or executed by personnel of the non-U.S. person located in a U.S. branch or office, or by personnel of such person's agent located in a U.S. branch of office.

As described in more detail below, we preliminarily believe that this proposed approach would mitigate many of the concerns raised by commenters in response to our initial proposal, while requiring persons that engage in dealing activity at levels that may raise the types of concerns that Title VII addresses to register as security-based swap dealers and comply with appropriate regulation. We also note that this approach would be generally consistent with the approach that we have followed with respect to the registration of brokers and dealers under the Exchange Act, which among other things requires that a broker-dealer physically operating in the United States register with the Commission and comply with relevant regulatory requirements, even if it directs its activities solely toward non-U.S. persons outside the United States.[97]

B. Proposed Application of De Minimis Exception to Non-U.S. Persons Arranging, Negotiating, or Executing Security-Based Swap Transactions Using Personnel Located in a U.S. Branch or Office

1. Overview of the initially proposed approach

As we noted in the Cross-Border Proposing Release, dealing activity carried out by a non-U.S. person through a U.S. branch, office, or affiliate or by a non-U.S. person that otherwise engages in security-based swap dealing activity in the United States, particularly at levels exceeding the relevant de minimis thresholds, may raise concerns that Title VII addresses, even if a significant proportion—or all—of those transactions involve non-U.S.-person

97 See Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 27017 (July 11, 1989), 54 FR 30013 (July 18, 1989).

counterparties.[98] Accordingly, we initially proposed to require any non-U.S. person to include in its de minimis calculation any security-based swap transaction connected with its dealing activities that is a "transaction conducted within the United States."[99] We proposed to define "transaction conducted within the United States" as any "security-based swap transaction that is solicited, negotiated, executed, or booked within the United States, by or on behalf of either counterparty to the transaction, regardless of the location, domicile, or residence status of either counterparty to the transaction."[100] Thus, under this initially proposed definition, a non-U.S. person engaged in dealing activity would have been required to include in its de minimis calculation any transaction where either the dealer itself or its counterparty, or the agent of either the dealer or the counterparty, performed relevant security-based swap dealing activity within the United States.[101]

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98 See Cross-Border Proposing Release, 78 FR 31000-01.

99 See initially proposed 3a71-3(b)(1)(ii).

100 See initially proposed Exchange Act rule 3a71-3(a)(5). See also Cross-Border Proposing Release, 78 FR 30999-31000. To address anticipated operational challenges associated with determining whether a person's counterparty is engaging in dealing activity within the United States that would make the transaction a "transaction conducted within the United States," we also proposed permitting reliance on a representation by a counterparty that the transaction was not solicited, negotiated, executed, or booked within the United States by or on behalf of that counterparty. See id. at 31001.

101 As we noted in the Cross-Border Proposing Release, the term "transaction conducted within the United States" was intended to identify key aspects of a transaction that, if carried out within the United States by either counterparty, would trigger the need for a non-U.S. person acting in a dealing capacity to include transactions arising out of that activity in its de minimis calculation. See id. at 30999-31000. The initially proposed definition of "transaction conducted within the United States" did not include submitting a transaction for clearing in the United States, reporting a transaction to a security-based swap data repository in the United States, or performing collateral management activities (such as exchanging margin) within the United States. See id. at 31000.

2. Commenters' views on the Cross-Border Proposing Release

Our initially proposed definition of "transaction conducted within the United States" and our proposed use of that term to trigger various Title VII requirements generated a significant volume of comment addressing a wide range of issues. Although two commenters supported our proposal,[102] commenters generally criticized the proposed definition. These criticisms generally focused on four areas: the scope of activity potentially captured by the initially proposed defined term, the operational difficulties of implementing the defined term, the costs of implementation, and competitive concerns.

(a) Scope of the initially proposed definition of "transaction conducted within the United States"

Several commenters took issue with the scope of the initially proposed defined term. Some commenters argued that the initially proposed definition was inappropriate in the context of Title VII because it would capture transactions between two non-U.S. persons that happened to involve conduct within the United States, even though such transactions are unlikely to create risk to the U.S. financial system.[103] Commenters also expressed concern that the initially

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102 See note 26, supra.

103 See SIFMA/FIA/FSR Letter at 4, A-3 (explaining that a transaction between two non-U.S. counterparties does not create risk in the United States, even where it is conducted within the United States); Letter from European Commission ("EC") to SEC, dated August 21, 2013 ("EC Letter") at 2 (suggesting that the Commission's rules should not apply to transactions when conduct within the United States involves two non-U.S. counterparties because no U.S. firms are at risk); Letter from European Securities and Markets Authority ("ESMA") to SEC, dated August 21, 2013 ("ESMA Letter") at 2 (requesting the Commission limit the definition of "transaction conducted within the United States" to transactions booked within the United States because that is the only activity that directly creates risk within the United States); Letter from Futures and Options Association ("FOA") to SEC, dated August 21, 2013 ("FOA Letter") at 7 (arguing that the test as initially proposed does not serve the goals of preserving the integrity of U.S. financial markets and protecting U.S. counterparties because it reaches transactions with minimal nexus to the United States).

Two of these commenters suggested that the initially proposed approach exceeded the Commission's authority under section 30(c) of the Exchange Act. See SIFMA/FIA/FSR Letter at proposed definition was overly broad because it would capture incidental or peripheral activity within the United States,[104] arguing that such overbreadth could lead to conflicting or duplicative application of regulations for certain market participants.[105]

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4 and A-4 to A-5 (suggesting that Exchange Act section 30(c) does not authorize the Commission to extend its authority through a conduct-based approach where no risk is imported to the United States); FOA Letter at 7 (stating that test goes beyond limits of Exchange Act section 30(c)). Another commenter stated that the initially proposed approach was inappropriate because it would have the effect of applying Title VII to transactions between two non-U.S. persons without having an international agreement regarding extraterritorial application of each jurisdiction's regulations. See Letter from Japan Securities Dealers Association ("JSDA") to SEC, dated August 21, 2013 ("JSDA Letter") at 3.

104 See Letter from Managed Funds Assoc. and Alternative Investment Management Assoc. ("MFA/AIMA") to SEC, dated August 19, 2013 ("MFA/AIMA Letter") at 4 and n.18 (stating that the lack of a materiality threshold would inappropriately subject transactions to Commission regulation, including transactions negotiated during an employee's visit to the United States); SIFMA/FIA/FSR Letter at A-2 (explaining that "transaction conducted within the United States" may include incidental conduct, which includes, in this commenter's view, a decision by a non-U.S. counterparty to use a contact based in the United States to execute a transaction only because executing it in the non-U.S. counterparties' jurisdictions would be inconvenient or impossible due to the timing of the transaction); Letter from Pensions Europe to SEC, dated September 3, 2013 ("Pensions Europe Letter") at 1 (stating that trades executed outside the United States by European pension fund managers should not be brought within Title VII only because the managers wish to "benefit from the expertise and experience of U.S. operations"); Letter from Institute of International Bankers ("IIB") to SEC, dated August 21, 2013 ("IIB Letter") at 10 (noting that the initially proposed test could capture transactions where the U.S.-based conduct is only clerical or ministerial); Letter from Investment Adviser Association ("IAA") to SEC, dated August 21, 2013 ("IAA Letter") at 6-7 (stating that the initially proposed test may capture parties with minimal connection to the United States, such as a non-U.S. counterparty using a U.S. investment adviser to manage its assets); Letter from Investment Company Institute ("ICI") to SEC, dated August 21, 2013 ("ICI Letter") at 4, 8-9 (stating that exception from the definition should be broader for non-U.S. counterparties that use U.S.-based investment managers and that the retention of a U.S. asset manager should not cause transactions to be subject to various regulatory requirements because a non-U.S. entity would not expect to be subject to U.S. regulation based on its retention of a U.S. asset manager); Letter from Japan Financial Markets Council ("JFMC") to SEC, dated August 15, 2013 ("JFMC Letter") at 5 (stating that the transactions could be captured by the definition solely because they are executed through a U.S. trading facility).

105 See IIB Letter at 8-9 (explaining that, because European regulations would apply to transactions between two U.S. branches of European firms, the initially proposed approach would cause duplicative and conflicting regulation); IIB letter at 10 (stating that a conduct-based test would subject U.S. agents already registered with the Commission or exempted from registration under broker-dealer or investment adviser regulations to additional regulation). See also EC Letter at 2 (suggesting that the Commission's rules should not apply to transactions when the legal counterparty to a transaction conducted within the United States is a non-U.S. entity because such

(b) Operational challenges

One commenter recognized the concerns that the initially proposed definition of "transaction conducted within the United States" was intended to address but expressed doubt as to whether funds would be able to monitor and confirm whether their dealing counterparties were engaging in dealing activity within the United States.[106] A number of commenters expressed concern that the defined term and its initially proposed application in the context of specific Title VII requirements, would present significant operational challenges for market participants more generally.[107] For example, one commenter noted that the approach would require market participants to make determinations on a trade-by-trade basis as to whether a transaction was "conducted within the United States" and would create inefficiencies and uncertainty in the market.[108] This commenter stated that the initially proposed approach was vague, and would be difficult to enforce and easy to manipulate.[109] One commenter specifically argued that

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persons are subject to regulation in their home jurisdiction); ESMA Letter at 2-3 (noting that the initially proposed approach could subject a transaction between two non-U.S. persons that is solicited in the United States to the regulations of multiple jurisdictions); FOA Letter at 7 (requesting that the Commission defer to regulatory oversight of counterparties' home country regulators).

106 See MFA/AIMA Letter at 4 (acknowledging the Commission's interest in preventing evasion of Title VII but expressing concern that private funds that are not U.S. persons may not be able to determine whether dealer counterparties have engaged in relevant conduct within the United States and may not be able to obtain relevant representations from such counterparties).

107 See, e.g., IIB Letter at 11 (stating that the initially proposed definition is ill suited to the global nature of the derivatives markets where activity may involve multiple physical locations); JFMC Letter at 4-5 (noting that the initially proposed definition is impracticable and would subject participants to duplicative and conflicting rules); JSDA Letter at 3 (expressing concern about the activity-based approach because of the operational confusion it may cause by subjecting market participants to the two separate approaches of the Commission and CFTC); ABA Letter at 3 (identifying ambiguities in the initially proposed definition, including whether negotiations over ISDA documentation are relevant conduct for purposes of the transaction).

108 See Letter from Americans for Financial Reform ("AFR") to SEC, dated August 22, 2013 ("AFR Letter") at 3, A-2 to A-3.

109 See AFR Letter at 3.

operational difficulties in tracking the location of conduct on a trade-by-trade basis might be impossible to overcome.[110]

(c) Cost concerns

Some commenters stated that applying Title VII to transactions merely because they involve conduct within the United States could not be justified from a cost-benefit perspective. Some contended that the CFTC had not taken such an approach and that divergence from the CFTC on the treatment of such conduct would impose a significant additional cost on market participants.[111] One commenter also noted that, whereas the "U.S. person" definition would typically be applied only at the beginning of a trading relationship, market participants would potentially be required to perform a trade-by-trade analysis to determine whether it involved conduct within the United States, which could significantly increase costs.[112]

(d) Competitive concerns

Some commenters expressed concern that focusing on "transactions conducted within the United States" would put brokers and investment managers located in the United States at a competitive disadvantage to their foreign counterparts, on the grounds that foreign clients would avoid doing business with them to avoid having their transactions become subject to

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110 See IIB Letter at 8.

111 See SIFMA/FIA/FSR Letter at 3, A-3, A-6 (arguing that the Commission should harmonize its approach to cross-border security-based swap activity to the approach reflected in the commenter's view of the CFTC Cross-Border Guidance); Pensions Europe Letter at 2 (preferring its view of the CFTC approach in the CFTC Cross-Border Guidance, which the commenter argues focuses on the location of principal headquarters); IIB Letter at 8 (stating that market participants would incur costs and burdens to modify their existing systems in order to comply with two different tests); JFMC Letter at 4-5 (urging that the Commission not adopt the defined term "transaction conducted within the United States" because the CFTC did not discuss such an approach in the CFTC Cross-Border Guidance).

112 See IIB Letter at 8 (stating that a conduct-based test would be costly and disruptive).

Commission regulations.[113] Another commenter, although critical of our initially proposed definition as excessively costly to implement, urged that any alternative to the conduct-based test described in the Cross-Border Proposal Release be designed to ensure that market participants from the United States were not put at a competitive disadvantage.[114]

(e) Other concerns

A few commenters, including some who expressed the concerns outlined above, sought clarification or made suggestions related to limiting the scope of the initially proposed defined term.[115] One commenter expressed support for the SEC's position in the proposal that the location where a transaction is cleared should not factor into determining whether a non-U.S. person qualifies as a security-based swap dealer.[116] Another commenter requested that, if the Commission adopts the "transaction conducted within the United States" test, market participants

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[113] See IIB Letter at 8-9.

[114] See SIFMA/FIA/FSR Letter at A-6.

[115] See IIB Letter at 9-11 (requesting clarification as to what degree of solicitation, negotiation, or execution activity would trigger the initially proposed definition); ESMA Letter at 2-3 (inviting the Commission to clarify which transactions between a U.S. branch of a foreign firm would be considered "conducted within the United States" and arguing that location of booking alone should be considered); FOA Letter at 7 (suggesting that, if a transaction has more than a de minimis connection to the United States as a result of solicitation or negotiation in the United States, the Commission should focus its regulatory authority on the intermediary performing those activities); JSDA Letter at 3 (suggesting that the Commission limit the application of Title VII to those transactions booked by non-U.S. persons with U.S. persons and requesting that certain activity related to "operational activities" be excluded from the activity covered by the initially proposed definition); ABA Letter at 3-4 (supporting the initially proposed definition but suggesting clarification that it excludes a firm's centralized risk management and legal and compliance functions).

[116] See Letter from CME Group ("CME") to SEC, dated August 21, 2013 ("CME Letter") at 2 (citing Cross-Border Proposing Release, 78 FR 31000).

should be permitted to rely on their counterparties' representations as to whether the transaction was conducted within the United States.[117]

3. The CFTC Staff Advisory and responses to the CFTC Request for Comment

As already noted, in November 2013, subsequent to the close of the comment period for our Cross-Border Proposing Release, CFTC staff issued the CFTC Staff Advisory, which addressed activity by registered swap dealers occurring within the United States.[118] The CFTC Staff Advisory stated the CFTC staff's belief that the CFTC "has a strong supervisory interest in swap dealing activities that occur within the United States, regardless of the status of the counterparties" and that a non-U.S. swap dealer "regularly using personnel or agents located in the U.S. to arrange, negotiate, or execute a swap with a non-U.S. person generally would be required to comply with" the CFTC's transaction-level requirements.[119]

As noted above, on January 8, 2014, the CFTC published the CFTC Request for Comment on various aspects of the CFTC Staff Advisory, including whether the CFTC "should adopt the Staff Advisory as Commission policy, in whole or in part."[120] In response to this request, the CFTC received approximately 20 comment letters addressing various aspects of the CFTC Staff Advisory, including its relationship to the CFTC Cross-Border Guidance and its general workability given current market practices. CFTC staff subsequently extended no-action relief related to the CFTC Staff Advisory until the earlier of September 30, 2015, or the effective

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117 See JSDA Letter at 4. Another commenter, however, expressed concern about being able to obtain, and being able to confirm the accuracy of, such representations. See MFA/AIMA Letter at 4.

118 See CFTC Staff Advisory.

119 Id. at 2.

120 See CFTC Request for Comment, 79 FR 1347.

date of any CFTC action in response to the CFTC Request for Comment.[121] We understand that the CFTC Staff Advisory and the related comment letters are currently under review by the CFTC. Although the CFTC Staff Advisory raises issues that are, to a certain degree, distinct from those raised by our initially proposed definition and use of "transaction conducted within the United States," the comments received by the CFTC in response to the CFTC Request for Comment in many cases elaborate on issues that commenters raised in response to our Cross-Border Proposing Release. Given similarities between the approach set forth in the CFTC Staff Advisory and our proposed amendments identifying relevant conduct within the United States, in this section we provide our own brief summary of relevant comments received by the CFTC.[122]

A few commenters supported the CFTC Staff Advisory. One commenter urged the CFTC to formally adopt the approach in the CFTC Staff Advisory, arguing that any weakening of it would permit "nominally foreign entities" to do business within the United States in compliance with foreign laws and regulations, or potentially subject to no legal requirements, rather than with U.S. law.[123] Another commenter stated that formal adoption of the CFTC Staff Advisory was unnecessary but urged the CFTC to leave it undisturbed, arguing that without the CFTC Staff Advisory, a U.S. person would effectively be able to enter into transactions with

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121 See note 25, supra.

122 As reflected in our discussion throughout this release, we have carefully considered both the CFTC Staff Advisory and the comments submitted in response to the CFTC's request for comment on the CFTC Staff Advisory in developing this proposal. Moreover, in connection with our statutory obligation to consult with the CFTC in connection with Title VII rulemaking, our staff have engaged in extensive discussion with CFTC staff regarding our proposed rules. We note, however, that our discussion of both the CFTC Staff Advisory and the comments received by the CFTC about it reflects our understanding of these documents. Accordingly, neither our discussions of these documents nor any preliminary views expressed herein should be interpreted as necessarily reflecting the views of any other agency or regulator, including the CFTC.

123 See Letter from American for Financial Reform ("AFR") to CFTC, dated March 10, 2014 ("AFR Letter to CFTC") at 3-4. See also Letter from Institute for Agriculture and Trade Policy ("IATP") to CFTC, dated March 10, 2014 ("IATP Letter to CFTC") at 1-2.

non-U.S. persons through its foreign affiliates while using U.S.-based trading operations, "thereby evading and gutting the key components of financial reform."[124]

Most commenters, however, opposed the approach taken in the CFTC Staff Advisory. These commenters expressed several concerns that may also be relevant to our own proposal to impose certain Title VII requirements on security-based swap activity that is carried out from a U.S. location, including the following: (1) the scope of the activity that would trigger application of Title VII, (2) the workability and costs of complying with such a test and resulting effects on competition and comity, and (3) the CFTC's transaction-level requirements that should be triggered by such a test. We will discuss the first two sets of concerns here and the third in Section V below.

(a) Scope of the CFTC Staff Advisory

Several commenters argued that the scope and types of activity by non-U.S. swap dealers captured by the CFTC Staff Advisory were unclear. The CFTC Staff Advisory notes that "persons regularly arranging, negotiating, or executing swaps for or on behalf of [a swap dealer] are performing core, front-office activities of that [swap dealer's] dealing business."[125] Accordingly, it expresses the CFTC staff's view that the CFTC's transaction-level requirements apply to transactions of registered non-U.S. swap dealers with non-U.S.-person counterparties when they "arrange, negotiate, or execute" those transactions "using personnel or agents located in the U.S."[126] Commenters argued that "arrange" and "negotiate" were overly broad and could

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124 Letter from Better Markets to CFTC, dated March 10, 2014 ("Better Markets Letter to CFTC") at 6.

125 CFTC Staff Advisory at 2.

126 Id.

encompass activity that occurred only incidentally in the United States.[127] Some commenters also noted that the apparent scope of the CFTC Staff Advisory was overly broad because non-U.S.-person counterparties may not typically know where the dealer engages in relevant conduct with respect to a particular swap transaction.[128]

Some commenters encouraged the CFTC to address these concerns by providing "detailed definitions" of the relevant terms or to focus only on execution or other discrete activities related to the transaction.[129] Several commenters urged the CFTC to abandon the CFTC Staff Advisory's approach altogether, or, if not, to revise the CFTC Staff Advisory's approach to focus on activities involving direct communication with the counterparty to the swap.[130]

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[127] See, e.g., Letter from Investment Adviser Association to CFTC, dated March 10, 2014 ("IAA Letter to CFTC") at 5; Société Générale Letter to CFTC at 7-8 (arguing that key terms of CFTC Staff Advisory are ambiguous and do not reflect how swap business is carried out). Some commenters also raised concerns regarding ambiguity in the CFTC Staff Advisory's use of the term "regularly." See, e.g., Letter from Securities Industry and Financial Markets Association/Futures Industry Association/Financial Services Roundtable to CFTC, dated March 10, 2014 ("SIFMA/FIA/FSR Letter to CFTC") at 16.

[128] See, e.g., Letter from Société Générale to CFTC, dated March 10, 2014 ("Société Générale Letter to CFTC") at 8 (stating that "[m]ost clients have no control or knowledge over where their swap is structured or designed, where the salesperson responsible for a particular product is located, where the booking of their swap is entered into a trading system, or where their swap is hedged").

[129] See, e.g., Letter from European Commission to CFTC, received March 10, 2014 ("EC Letter to CFTC") at 3. See also SIFMA/FIA/FSR Letter to CFTC at A-8 to A-9; IAA Letter to CFTC at 5 (urging CFTC to focus on where the swap was executed or cleared).

[130] See Letter from ISDA to CFTC, dated March 7, 2014 ("ISDA Letter to CFTC") at 8 n.16 (arguing that, if the CFTC determines to adopt the CFTC Staff Advisory, it should limit triggering conduct solely to "direct communications by SD personnel located in the United States with counterparties, which communications commit the SD to the execution of a particular swap transaction"); Letter from Barclays to CFTC, dated March 10, 2014 ("Barclays Letter to CFTC") at 4 (arguing that "only direct communication with counterparties by non-U.S. swap dealers to the execution of the transaction should trigger application of the pre-trade disclosure requirements" and that "the [CFTC] should explicitly exclude electronic or screen-based execution" as such conduct "does not involve direct interaction" and the "non-U.S. person counterparty will not know who is responding on behalf of the non-U.S. swap dealer, let alone the responder's location," meaning that "the non-U.S. counterparty will not have a reasonable expectation that the

(b) Workability, costs, and competitive effects of the CFTC's activity-based approach

Some commenters expressed concern that the CFTC Staff Advisory reflected a significant departure from the approach that these commenters understood to be the focus of the CFTC Cross-Border Guidance.[131] These commenters argued that developing systems consistent with the CFTC Staff Advisory would cause them to incur significant additional costs.[132] In particular, commenters stated their belief that developing systems consistent with the CFTC Staff Advisory would require a trade-by-trade analysis, which would be impracticable.[133] One commenter argued that these costs would not be justified by corresponding benefits because

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transaction may be subject to protection under U.S. law"); SIFMA/FIA/FSR Letter to CFTC at A-11 to A-12 (arguing that, if the CFTC decides to adopt the approach in the CFTC Staff Advisory, it should capture only "direct communications by personnel in the United States with counterparties that commit the SD to the execution of the transaction" because, absent direct communication, the counterparty has no reason to expect that U.S. law will apply to the transaction). See also Société Générale Letter to CFTC at 8 (stating that, if the CFTC does adopt the CFTC Staff Advisory, the CFTC should focus only on salespersons based in the United States that deal directly with clients).

131 See Société Générale Letter to CFTC at 2 (explaining that market participants have already developed systems to reflect the status-based approach); Letter from Institute of International Bankers to CFTC, dated March 10, 2014 ("IIB Letter to CFTC") at 2-3 (noting among other things that market participants have built policies and systems to reflect their view of the CFTC's approach in the CFTC Cross-Border Guidance and that they believe the approach taken in the CFTC Staff Advisory is fundamentally different); ISDA Letter to CFTC at 5 (arguing that systems are not configured to identify personnel that are involved in a transaction but rather to be consistent with the CFTC Cross-Border Guidance, and that the CFTC Staff Advisory raises complex questions about, e.g., portfolio margining); SIFMA/FIA/FSR Letter to CFTC at A-2 (stating that the CFTC's approach in the CFTC Cross-Border Guidance is already overbroad, and applying the CFTC Staff Advisory on top of the entity-based approach is "particularly flawed," "compound[ing] the excessive breadth and burden of the existing, entity-based regulatory structure by approaching swaps regulation from an entirely different direction, layering even more requirements and burdens onto market participants, and doing so in the absence of any discernible risk to U.S. markets").

132 See, e.g., Société Générale Letter to CFTC at 2.

133 See, e.g., Société Générale Letter to CFTC at 8; SIFMA/FIA/FSR Letter to CFTC at A-4 (explaining that the approach taken in the CFTC Staff Advisory is impracticable in the swap market, as it would require a trade-by-trade analysis that is not feasible and that requiring such trades to be fully isolated from the United States would interfere with the operations of these markets and market participants).

market participants likely would already be subject to similar requirements in their home jurisdiction.[134]

One commenter criticized the CFTC Staff Advisory's focus on whether a registered non-U.S. swap dealer is arranging, negotiating, or executing a swap using personnel or agents in the United States as providing insufficient guidance to market participants, arguing that these activities do not reflect current business practices among swap dealers.[135] For example, this commenter stated that some personnel of a dealer may design swaps and hedging solutions but lack authority to book the resulting swaps and have no interaction with clients; these same personnel may book swaps that other employees have sold or negotiated for risk mitigation purposes.[136] The commenter further noted that personnel involved in a particular swap may be located in multiple jurisdictions.[137]

Several commenters argued that the costs and impracticability of the approach taken in the CFTC Staff Advisory would have competitive effects, although they disagreed whether it would enhance or degrade competition. One commenter supported the CFTC Staff Advisory in its current form, noting that without it, U.S. firms would be at a competitive disadvantage compared to non-U.S. firms operating in the United States.[138] Other commenters argued that the

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134 See IIB Letter to CFTC at 3.

135 See Société Générale Letter to CFTC at 8.

136 See id.

137 See id.

138 See AFR Letter to CFTC at 3 (explaining that "any weakening of [the] advisory would open the door to regular and significant levels of swaps activities being performed within the U.S. by nominally foreign entities under foreign rules, or in some cases no rules at all," whereas U.S. firms operating in the United States would be subject to different rules for the same transactions operating in the same market).

CFTC Staff Advisory, if adopted, would have adverse competitive effects on certain end users.[139]

Some commenters also suggested that, if adopted by the CFTC, the approach taken in the CFTC Staff Advisory could present difficulties for, and impose costs on, non-U.S.-person counterparties of dealers, as such counterparties may not currently have systems in place for complying with certain CFTC requirements, particularly if they are imposed only because the swap dealer (and not the counterparty) happens to have carried out certain activities using personnel or agents located in the United States.[140] As a result, commenters argued non-U.S. swap dealers may no longer service non-U.S.-person counterparties from U.S. locations.[141]

Commenters suggested that pressure from non-U.S.-person counterparties that do not want their transactions to be subject to Title VII would lead at least some non-U.S.-person dealers to exit the United States.[142] Commenters suggested that the adoption of the CFTC Staff Advisory would likely interfere with the ability of certain swap dealers to cover U.S. market hours for foreign counterparties with U.S.-based personnel, increasing costs to counterparties and end users.[143]

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139 See Letter from Coalition for Derivatives End-Users ("CDEU") to CFTC, dated March 10, 2014 ("CDEU Letter to CFTC") at 2 (arguing that the CFTC Staff Advisory would lead to competitive disadvantages for certain non-U.S. end-user affiliates that had relied on trading with non-U.S. swap dealers compared to other non-U.S. end users in the same markets that currently hedge with unregistered counterparties).

140 See, e.g., SIFMA/FIA/FSR Letter to CFTC at A-4 (explaining that certain non-U.S.-person counterparties may not have a clearing relationship with a futures commission merchant ("FCM"), and requiring them to clear through an FCM simply because the dealer happens to use personnel within the United States in the transaction will be costly).

141 See ISDA Letter to CFTC at 4.

142 See, e.g., Société Générale Letter to CFTC at 8 (stating that, if the CFTC adopts the CFTC Staff Advisory, or even an alternative suggested by the commenter, swap dealers "will move personnel currently based in the United States offshore").

143 See, e.g., Letter from Paul Hunter for the Japan Financial Markets Council to CFTC, dated March 4, 2014 ("JFMC Letter to CFTC") at 1-2 (explaining that the approach in the CFTC Staff Advisory "unfairly precludes options open to Asia-based Swap Dealers to cover U.S. market

4. Dealing activity of non-U.S. persons in the United States

We have carefully considered the views of commenters, as discussed above, that dealing activity carried out in the United States by a non-U.S. person with a counterparty that is also a non-U.S. person lacks a significant nexus to the United States and does not raise any significant regulatory concerns in the United States because the ongoing obligations associated with such transactions do not reside in the United States.[144] However, as we discuss below, we continue to believe that such activity falls squarely within our territorial approach to the application of Title VII[145] and that it raises regulatory concerns of the type that Title VII addresses.

(a) Overview of common business structures for firms engaged in security-based swap dealing activity

As we noted in our Cross-Border Proposing Release, financial groups engaged in security-based swap dealing activity use a variety of business models and legal structures to carry out such activity with counterparties around the world. Most such financial groups operate in multiple jurisdictions, and they will typically have one or more dealer affiliates in one or more

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hours and service their non-U.S. based clients by using U.S.-based personnel or agents"); CDEU Letter to CFTC at 2-3 (arguing that the CFTC Staff Advisory's approach would "force non-U.S. [swap dealers] that use personnel or agents to 'arrange, negotiate, or execute' swaps to exit certain markets or move personnel outside the U.S. in order to remain competitive in non-U.S. markets[,]" and that the costs associated with such movements would "undoubtedly be passed on to derivatives end-users and ultimately to customers...[which] would result in a loss of liquidity that will leave non-U.S. end-user affiliates scrambling to find counterparties to hedge their risks"). See also SIFMA/FIA/FSR Letter to CFTC at A-6 (explaining that the desire of counterparties to swap dealers to keep their transactions out of the reach of Dodd-Frank will lead them to pressure non-U.S.-person dealers and foreign branches to move personnel out of the United States); IAA Letter to CFTC at 3 (explaining that non-U.S.-person dealers may incur expenses associated with moving personnel out of the United States or hiring personnel in other jurisdictions, which may potentially lead to increased transaction costs and reduced services for advisers' non-U.S. clients, and that these higher costs may drive non-U.S. clients away from U.S. investment advisers).

144 See note 103, supra (identifying comment letters arguing that such transactions pose no risk to the United States or that the Commission lacks a regulatory interest in such transactions).

145 See Cross-Border Proposing Release, 78 FR 30986; Cross-Border Adopting Release, 79 FR 47290.

jurisdictions that book the security-based swap transactions related to their security-based swap dealing business. An affiliate that initially books a transaction may retain the risk associated with that transaction, or it may lay off that risk to another affiliate via a back-to-back transaction or an assignment of the security-based swap.[146] These decisions generally reflect the financial group's consideration of, among other things, how it may most efficiently manage the risks associated with its security-based swap positions.

The structure of the group's market-facing activities that generate the transactions booked in these affiliates often reflects different considerations. A dealing affiliate established in one jurisdiction may operate offices (which may serve sales or trading functions) in one or more other jurisdictions to deal with counterparties in that jurisdiction or in a specific geographic region, or to ensure that it is able to provide liquidity to counterparties in other jurisdictions, even when a counterparty's home financial markets are closed. A dealer also may choose to manage its trading book in particular reference entities or securities primarily from a trading desk that can take advantage of local expertise in such products or to gain access to better liquidity, which may permit it to more efficiently price such products or to otherwise compete more effectively in the security-based swap market. We understand that a financial group that engages in a dealing business may have business lines that are carried out in a number of affiliates located in different jurisdictions, and that personnel of an affiliate may operate under the direction of, or in some cases, report to personnel of another affiliate within the group; in some cases, such personnel work on behalf of, or under the supervision of, more than one affiliate in the group.

Moreover, a dealer may carry out these market-facing activities, whether in its home jurisdiction or in a foreign jurisdiction, using either its own personnel or the personnel of an

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[146] See Cross-Border Proposing Release, 78 FR 30977-978.

affiliated or unaffiliated agent. For example, the dealer may determine that another affiliate in the financial group employs personnel who possess expertise in relevant products or that have established sales relationships with key counterparties in a foreign jurisdiction, making it more efficient to use the personnel of the affiliate to engage in security-based swap dealing activity on its behalf in that jurisdiction.

Alternatively, the dealer may in some circumstances determine to engage the services of an unaffiliated agent through which it can engage in dealing activity. For example, a dealer may determine that using an inter-dealer broker may provide an efficient means of participating in the inter-dealer market in its own, or in another, jurisdiction, particularly if it is seeking to do so anonymously or to take a position in products that trade relatively infrequently.[147] Dealers may also use unaffiliated agents that operate at the direction or request of the dealer to engage in dealing activity. Such arrangement may be particularly valuable in enabling the dealer to service clients or access liquidity in jurisdictions in which the dealer or its affiliates have no security-based swap operations of their own.

We understand that dealers established in foreign jurisdictions (whether affiliated with U.S.-based financial groups or not) may use any of these structures to engage in dealing activity in the United States, and that they may seek to engage in dealing activity in the United States to transact with both U.S. and non-U.S.-person counterparties. In transactions with non-U.S.-person counterparties, a foreign dealer may affirmatively seek to engage in dealing activity in the United States because the sales personnel of the foreign dealer (or of its agent) in the United

147 We understand that inter-dealer brokers may provide voice or electronic trading services that, among other things, permit dealers to take positions or hedge risks in a manner that preserves their anonymity until the trade is executed. These inter-dealer brokers also may play a particularly important role in facilitating transactions in less-liquid security-based swaps.

States have existing relationships with counterparties in other locations (such as Canada or Latin America) or because the trading personnel of the foreign dealer (or of its agent) in the United States have the expertise to manage the trading books for security-based swaps on U.S. reference securities or entities. And we understand that some foreign dealers engage in dealing activity in the United States through their personnel (or personnel of their affiliates) in part to ensure that they are able to provide their own counterparties, or those of financial group affiliates in other jurisdictions, with access to liquidity (often in non-U.S. reference entities) during U.S. business hours, permitting them to meet client demand even when the home markets are closed. In some cases, such as when seeking to transact with other dealers through an inter-dealer broker, a foreign dealer may act, in a dealing capacity, in the United States through an unaffiliated, third-party agent.

(b) Statutory scope and policy concerns arising from security-based swap dealing activity in the United States

As discussed above, some commenters have suggested that the Title VII statutory framework does not extend to transactions between two non-U.S. persons, even if security-based swap activity occurs in the United States, and have argued that section 30(c) of the Exchange Act limits our authority to reach this conduct.[148] We continue to believe, however, that it is consistent with the Exchange Act to impose specific Title VII requirements on non-U.S. persons that engage in activity within the United States that is regulated by the relevant statutory provision.[149]

148 See note 103, supra.

149 See Cross-Border Adopting Release, 79 FR 47287. As we noted in the Cross-Border Adopting Release, when the statutory text does not describe the relevant activity with specificity or provides for further Commission interpretation of statutory terms or requirements, our territorial analysis may require us to identify through interpretation of the statutory text the specific activity

In the Cross-Border Adopting release, we described how this approach applies in the specific context of the definition of "security-based swap dealer." We rejected the view that "the location of risk alone should . . . determine the scope of an appropriate territorial application of every Title VII requirement," including the application of the "security-based swap dealer" definition.[150] In doing so, we noted that "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."[151]

Instead, the statute identifies specific activities that bring a person within the definition of "security-based swap dealer": (1) holding oneself out as a dealer in security-based swaps, (2) making a market in security-based swaps; (3) regularly entering into security-based swaps with counterparties as an ordinary course of business for one's own account; or (4) engaging in any activity causing oneself to be commonly known in the trade as a dealer in security-based swaps.[152] We have further interpreted this definition to apply to persons engaged in indicia of dealing activity, including, among other things, providing liquidity to market professionals, providing advice in connection with security-based swaps, having regular clientele and actively soliciting clients, and using inter-dealer brokers.[153] Neither the statutory definition of "security-

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that is relevant under the statute or to incorporate prior interpretations of the relevant statutory text. See id.

150 Id. at 47287-88.

151 Id. at 47288. We have also noted that security-based swap dealer regulation may be warranted either to promote market stability and transparency in light of the role that these dealers occupy in the security-based swap market or to address concerns raised by the nature of the interactions between such dealers and their counterparties. See Intermediary Definitions Adopting Release, 77 FR 30617.

152 See Exchange Act section 3(a)(71)(A), 15 U.S.C. 78c(a)(71)(A).

153 See Intermediary Definitions Adopting Release, 77 FR 30617-18.

based swap dealer" nor our further definition of that term turns primarily on the presence of risk or on the purchase or sale of any security, including a security-based swap.[154]

Accordingly, the fact that the counterparty credit risk from a transaction between two non-U.S. persons, where neither counterparty has a right of recourse against a U.S. person under the security-based swap, exists largely outside the United States is not determinative under our territorial analysis. The appropriate analysis, in our view, is whether a non-U.S. person in such a transaction is engaged, in the United States, in any of the activities set forth in the statutory definition or in our further definition of "security-based swap dealer." If it is so engaged, in our view, it is appropriate under a territorial approach to require the non-U.S. person to include such transaction in its security-based swap dealer de minimis threshold calculations and, if those security-based swaps (and any other security-based swaps it is required to include in its threshold calculations) exceed the de minimis threshold, to register as a security-based swap dealer.[155]

This analysis applies regardless of whether the non-U.S. person engages in dealing activity (as described in the statutory definition and in our further definition of "security-based swap dealers") in the United States using its own personnel or using the personnel of an agent acting on its behalf. As described above, persons engaged in security-based swap dealing activity routinely do so both directly and through their agents. Indeed, our further definition of

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154 See Exchange Act section 3(a)(71)(A), 15 U.S.C. 78c(a)(71)(A); Intermediary Definitions Adopting Release, 77 FR 30617-18.

155 See Cross-Border Adopting Release, 79 FR 47286-92 (describing the Commission's territorial approach). We note that another commenter argued that it was inappropriate to use activity in the United States to trigger application of Title VII absent an international agreement between regulators. See note 103, supra. As discussed above, we have continued to consult and coordinate with other regulators in the United States and abroad in connection with financial market reforms, see note 12 and accompanying discussion, but we do not believe that an international agreement is relevant as a legal or policy matter in determining whether to impose Title VII requirements on security-based swap activity, particularly given that we are proposing to do so with respect to activity that is being carried out in the United States.

"security-based swap dealer" specifically identifies the use of inter-dealer brokers as one of several indicia of security-based swap dealing activity,[156] and, in our preliminary view, engaging an inter-dealer broker as agent or sending a trade to such a broker generally would be dealing activity; to the extent that this activity is directed to a broker in the United States, we preliminarily believe that the non-U.S. person would be engaged in dealing activity in the United States.[157] Accordingly, a non-U.S. person that reaches into the United States by engaging an agent (including an inter-dealer broker) to perform dealing activity on its behalf is itself engaged, at least in part, in dealing activity in the United States. We preliminarily believe that it is appropriate under a territorial approach to require the non-U.S. person to include transactions arising out of those activities in its own de minimis threshold calculations.

Finally, in light of the foregoing analysis, we note that the statutory prohibition on application of Title VII requirements to persons that "transact[] a business in security-based swaps without the jurisdiction of the United States" has no bearing on these proposed rules.[158] Our proposed approach, as described in further detail below, would require transactions to be included in a non-U.S. person's dealer de minimis threshold calculations only when, in connection with its dealing activity, it arranges, negotiates, or executes a security-based swap using its personnel (or personnel of its agent) located in the United States.[159] Because we are

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156 See Intermediary Definitions Adopting Release, 77 FR 30617-18 (further defining "security-based swap dealer").

157 More generally, we note that the routine use by dealers of the structures described in this discussion suggest that a person may engage in dealing activity through an agent in a manner very similar to such activity carried out through its own branch or office. Cf. Exchange Act section 3(a)(71)(A) (defining "security-based swap dealer"); Intermediary Definitions Adopting Release, 77 FR 30617-18 (further defining "security-based swap dealer").

158 See Exchange Act section 30(c).

159 See Exchange Act rule 3a71-3(a)(1).

focusing in this proposal solely on transactions in which the non-U.S. person is engaged, directly or indirectly, in dealing activity in the United States, the proposed rules would not impose requirements on non-U.S. persons that are "transacting a business in security-based swaps without the jurisdiction of the United States" for purposes of section 30(c).[160] Accordingly, because such activities occur within the United States, they, and any resulting transaction, are within the scope of Title VII.

Moreover, we preliminarily believe that requiring these transactions to be included in a non-U.S. person's dealer de minimis threshold calculations (and subjecting them to certain other Title VII requirements, as discussed below) is consistent with the regulatory objectives furthered by the relevant Title VII requirements. Under the rules we adopted in the Cross-Border Adopting Release, financial groups may seek to avoid application of Title VII requirements to their security-based swap dealing activity with non-U.S. persons (including with other dealers),

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160 As noted above, we do not believe that our proposed approach applies Title VII to persons that 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. An approach that, for example, treated a non-U.S. person dealer that used an agent, whether affiliated or unaffiliated, in the United States to carry out some or all of its dealing business with non-U.S. persons (for example, because using a U.S. agent allowed it to leverage higher liquidity and lower spreads in U.S. reference entities) as transacting a business in security-based swaps without the jurisdiction of the United States, 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 various structures that non-U.S. persons use to engage in security-based swap dealing activity. But in any event we also preliminarily believe that this proposed 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 would help prevent the relevant purposes of the Dodd-Frank Act from being undermined. See Cross-Border Adopting Release, 79 FR 47291-92 (interpreting anti-evasion provisions of Exchange Act section 30(c)). Without this rule, non-U.S. persons could simply carry on a dealing business within the United States with other non-U.S. persons through agents and remain outside of the application of the dealer requirements of Title VII. Permitting this activity would allow these firms to retain full access to the benefits of operating in the United States while avoiding compliance with, for example, recordkeeping and reporting requirements and Regulation SBSR, which could reduce transparency in the U.S. market and make it considerably more difficult for the Commission to monitor the market for manipulation or other abusive practices.

even though they continue to carry out day-to-day sales and trading operations in the United States in a manner largely unchanged from what we understand to be current business practices.[161] For market participants, avoiding Title VII in such transactions in the absence of these proposed rules would require them only to book any such transactions in non-U.S. person dealers whose obligations under such swaps are not guaranteed by a U.S. person. Doing so would allow them to perform any other activities in connection with the transaction in the United States without complying with Title VII requirements.

Such a reaction could result in a significant amount of security-based swap dealing activity continuing to be engaged in by personnel located in a U.S. branch or office,[162] but, because the financial group chooses to book the transactions in a non-U.S.-person affiliate whose obligations under a security-based swap are not guaranteed by a U.S. person, certain Title VII requirements may not apply to such dealing activity. A dealer could continue to transact security-based swaps with other dealers (and with non-U.S. persons that are not dealers) through a U.S. sales and trading desk that is staffed by its own personnel or the personnel of its agent, continuing to engage in market-facing activity in the United States without complying with any Title VII requirements.

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161 We understand that there may be significant advantages in continuing to carry out certain market-facing activities using personnel located in the United States, depending on the location of the counterparty and the nature of the reference security or entity. For example, market expertise in security-based swaps on U.S. reference entities may be located primarily in the United States, and relationships with counterparties in certain geographical regions may be managed out of a U.S. branch or office. See Section III.B.4(a), supra.

162 This dealing activity likely would constitute inter-dealer activity, which, as noted above, accounts for a majority of activity in the security-based swap market. See Section II.B.2, supra. To the extent that there are advantages to trading U.S. reference entities from a U.S. location, activity by personnel located in the United States may account for a significant proportion of the inter-dealer business on those reference entities.

Although such transactions may not give rise to counterparty-credit risk within the United States, they do raise other regulatory concerns, particularly when a firm is engaged in such activity at levels above the dealer de minimis thresholds. We note that significant levels of security-based swap dealing activity occurring within the United States without being subject to dealer regulation or Regulation SBSR may pose a risk to the integrity of the U.S. financial market, as the absence of regulation—and of access, for example, to the security-based swap dealer's books and records—may make it significantly more difficult for the Commission to monitor the market for abusive and manipulative practices connected with security-based swap activity in the United States. As we have noted elsewhere, Title VII recordkeeping requirements will likely be the Commission's primary tool in monitoring compliance with applicable securities laws, including the antifraud provisions of these laws.[163] To the extent that we do not have access to reports of such transactions available through registered SDRs or to the books and records of non-U.S.-person dealers using personnel located in a U.S. branch or office, manipulative or abusive trading practices within the United States are more likely to go undetected, which may undermine the integrity of the security-based swap market in the United States, and of the U.S. financial market more generally.[164] For example, a dealer using personnel located in a U.S. branch or office may employ a trader who engages in trading practices in

[163] See Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain SBSDs; Proposed Rules, Exchange Act Release No. 71958 (April 17, 2014), 79 FR 25194, 25199 (May 2, 2014) (citing Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under the Electronic Signatures in Global and National Commerce Act of 2000 with Respect to Rule 17a–4(f), Exchange Act Release No. 44238 (May 1, 2001), 66 FR 22916 (May 7, 2001); Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, Exchange Act Release No. 44992 (October 26, 2001), 66 FR 55818 (November 2, 2001)).

[164] These concerns may arise whether the dealer is using its own personnel or personnel of an affiliated or unaffiliated agent. For example, a security-based swap dealer may provide its agent's personnel located in a U.S. branch or office with false or misleading information concerning the transaction, which the agent's personnel then may deliver to the counterparty.

connection with security-based swap transactions that render the dealing activity in the United States abusive or manipulative, but we may not be able to readily identify the abusive or manipulative nature of that dealing activity without access to the dealer's books and records.[165] Detecting misconduct may be particularly challenging if a significant proportion of transactions in the relevant security-based swaps are carried out in the United States by traders employed by unregistered dealers.

Moreover, these dealers could continue to trade—using U.S. sales and trading desks, and potentially the same sales and trading desks used by their registered security-based swap dealer affiliates—in the inter-dealer market in a manner that may be opaque to regulators and non-dealers alike. This risk, in our preliminary view, is particularly high given that, as we have noted, inter-dealer activity accounts for a significant proportion of all security-based swap activity. This activity, to the extent it is carried out by personnel located in the United States, should be subject to relevant regulatory requirements. Subjecting such transactions to Regulation SBSR and potentially requiring firms engaged in such activity to register as security-based swap dealers should bring additional transparency to what is likely to be a significant proportion of the security-based swap activity that occurs in the United States and provide market participants more confidence in the integrity of the market.

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165 A registered security-based swap dealer that is engaged in abusive or manipulative conduct with respect to a series of transactions may lay off risk from a transaction with a U.S. person counterparty to a foreign unregistered dealer via an affiliated foreign unregistered dealer, using personnel located in a U.S. branch or office. This conduct may not be apparent from the U.S. counterparty-facing leg or the inter-affiliate leg. Thus, even if the affiliated or unaffiliated agent has independent obligations arising from its role in the transaction, these obligations may not address potential abusive or manipulative practices in the transactions. Moreover, detecting such misconduct on the part of the affiliated foreign unregistered dealer, as discussed above, may be difficult absent access to regulatory reports of the relevant transactions and to the books and records of such dealer.

In light of these concerns, we preliminarily believe that it is appropriate to propose rules that would impose certain Title VII requirements on dealers using personnel located in the United States to engage in security-based swap dealing activity.

5. Proposed amendments regarding application of the dealer de minimis exception to non-U.S. persons using personnel located in a U.S. branch or office to arrange, negotiate, or execute security-based swap transactions

We have carefully considered the proposed application of the dealer de minimis exception to "transactions conducted within the United States" in light of comments received on the proposal, subsequent regulatory and other developments in the security-based swap market, and the policy concerns described in the preceding section. As a result, we are proposing an amendment to Exchange Act rule 3a71-3 that should address the regulatory concerns raised by dealing activity carried out using personnel located in the United States while mitigating many of the concerns expressed by commenters. Under this modified approach, we focus on market-facing activity by personnel located in the United States that reflects, in our view, a dealer's determination to engage in dealing activity in the United States in a manner that warrants, if the dealer exceeds the security-based swap dealer de minimis thresholds, application of Title VII security-based swap dealer regulation.

Unlike the initial proposal, which included the defined term "transaction conducted within the United States," the proposed amendment would not include a separate defined term identifying such activity. Rather, we propose to amend Exchange Act rule 3a71-3(b)(1)(iii) to require a non-U.S. person engaged in security-based swap dealing activity to include in its de minimis calculations any transactions connected with its security-based swap dealing activity that it arranges, negotiates, or executes using its personnel located in a U.S. branch or office, or using personnel of its agent located in a U.S. branch or office.[166] To the extent that a non-U.S. person, in connection with its dealing activity, engages in market-facing activity using personnel located in the United States, we preliminarily believe that it is reasonable to conclude that the person is performing activities that fall within the statutory definition of "security-based swap dealer" or our further definition of that term, as described above, at least in part in the United States.[167]

This proposed amendment reflects our reconsideration of the issues raised by security-based swap dealing activity involving two non-U.S. persons in which one or both parties, or the agents of one or both parties, using personnel located in the United States, engage in some dealing activity.[168] We preliminarily believe that requiring non-U.S. persons to include such transactions in their de minimis threshold calculations will help to ensure that all persons that

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166 See proposed Exchange Act rule 3a71-3(b)(1)(iii)(C). Because, as a threshold matter, a person would be required to include in its de minimis calculations only security-based swaps that are arranged, negotiated, or executed in connection with its dealing activity, a non-U.S. person would not be required to include in this calculation transactions solely on the basis that they were submitted for clearing in the United States or because activities related to collateral management of the transaction, such as the exchange of margin, occurred within the United States. See Cross-Border Proposing Release, 78 FR 31000.

167 Non-U.S. persons engaged in security-based swap dealing activity may include persons whose counterparties have legal recourse against a U.S. person arising out of the security-based swap transactions of the non-U.S. person or persons that are conduit affiliates. As noted above, our Cross-Border Adopting Release finalized rules providing that a non-U.S. person must include in its dealer de minimis calculation transactions arising out of its dealing activity with counterparties that are U.S. persons, or such transactions with non-U.S. persons if it is a conduit affiliate or if its counterparty has a right of recourse against a U.S. person under the security-based swap, even if it is not engaging in dealing activity using personnel located in the United States to arrange, negotiate, or execute the transaction. See Exchange Act rules 3a71-3(a)(1), (b)(1)(ii), and (b)(1)(iii)(B). Nothing in the proposed amendment to Exchange Act rule 3a71-3 should be construed to affect any person's obligations created by any of these previously adopted rules.

168 As noted above, some commenters argued that transactions between two non-U.S. persons do not create risk within the United States and should therefore not be subject to Title VII. See note 103, supra. As we have discussed above, however, even if such transactions do not raise counterparty credit risk in the United States, such transactions raise concerns about the integrity and transparency of the U.S. financial market. See discussion in Section III.B.4, supra (citing and responding to comment letters making this argument).

engage in significant relevant dealing activity, including activity engaged in by personnel located in a U.S. branch or office, are required to register as security-based swap dealers and to comply with relevant Title VII requirements applicable to security-based swap dealers.[169]

At the same time, this proposed approach is intended to avoid unnecessary costs and complexity that may make it difficult for market participants to comply with such requirements. We recognize commenters' concerns that our initially proposed approach to "transactions conducted within the United States" potentially could have imposed significant costs on, and presented compliance challenges to, market participants. As some commenters noted, the initially proposed definition of "transaction conducted within the United States" was sufficiently broad that it might have encompassed conduct within the United States by either counterparty to the transaction that could be characterized as "incidental."[170] In addition, market participants may have incurred costs associated with monitoring the location of relevant personnel acting on behalf of their counterparty and/or obtaining relevant representations from their counterparty on a transaction-by-transaction basis, potentially increasing compliance costs significantly.[171] We

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169 We note that some commenters urged us to abandon an activity-based approach entirely because, in their view, the CFTC had not adopted such an approach and, diverging from the CFTC by imposing such an approach on security-based swap transactions would result in significant additional costs for market participants. See note 111, supra. As noted above, however, although the CFTC has not finalized its view on such an approach, the CFTC Staff Advisory provided the CFTC staff view that non-U.S. swap dealers should comply with certain requirements with respect to swap transactions arranged, negotiated, or executed in the United States. See note 21, supra, and accompanying discussion. Although the CFTC Staff Advisory does not appear to address inclusion of swaps arranged, negotiated, or executed in the United States in the dealer de minimis calculations of non-U.S. persons, the test set forth in proposed Exchange Act rule 3a71-3(b)(1)(iii)(C) is similar to the approach suggested by the CFTC Staff Advisory for determining the applicability of certain transaction-level requirements. See Section III.B.3, supra.

170 See note 104, supra (citing comments expressing concern that the initially proposed definition of "transaction conducted within the United States" would capture incidental conduct within the United States).

171 See notes 108-110, supra.

preliminarily believe that our proposed approach of focusing solely on whether the non-U.S. person engaged in dealing activity is using personnel located in the United States to arrange, negotiate, or execute the security-based swap would address these concerns in a more workable manner. Consistent with this focus on the location of activity carried out by the personnel of the dealer or of its agent, the non-U.S. person engaged in dealing activity would not be required to consider the location of its counterparty's operations (or that of the counterparty's agent) in determining whether the transaction should be included in its own de minimis calculation.

In the following subsections, we describe key elements of the proposed amendment to Exchange Act rule 3a71-3(b)(1)(iii), and address comments of particular relevance with respect to each element.

(a) "Arranging, negotiating, or executing" a security-based swap transaction

Proposed rule 3a71-3(b)(1)(iii)(C) would apply only to transactions connected with a non-U.S. person's security-based swap dealing activity that its personnel (or the personnel of an agent) located in the United States arrange, negotiate, or execute. The proposed approach, accordingly, would reach a narrower range of activity than did the initially proposed rules that included the term "transaction conducted within the United States," which would have included any transaction solicited, negotiated, executed, or booked, by either party, within the United States.[172]

Consistent with our explanation for initially proposing the term "transaction conducted within the United States," we intend, for purposes of the proposed rule, "arrange" and

172 As noted above, the initially proposed rule would have required non-U.S. persons to include in their de minimis calculation any "transaction conducted within the United States" related to their dealing activity. See Cross-Border Proposing Release, 78 FR 30999-00.

"negotiate" to indicate market-facing activity of sales or trading personnel in connection with a particular transaction, including interactions with counterparties or their agents.[173] Also for purposes of the proposed rule, we intend "execute" to refer to the market-facing act that, in connection with a particular transaction, causes the person to become irrevocably bound under the security-based swap under applicable law. "Arranging," "negotiating," and "executing" also include directing other personnel to arrange, negotiate, or execute a particular security-based swap.[174]

We recognize that several commenters expressed concern about the terms used in our proposed definition of "transaction conducted within the United States"[175] and criticized the use of the terms "arrange, negotiate, or execute" in the CFTC Staff Advisory,[176] objecting to those terms both as ambiguous and as not reflective of how swap dealing activity is actually carried out

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173 See Cross-Border Proposing Release, 78 FR 31000 (noting that "dealing activity is normally carried out through interactions with counterparties or potential counterparties that include solicitation, negotiation, execution, or booking of a security-based swap").

Consistent with the approach taken to the final definition of "transaction conducted through a foreign branch" adopted in the Cross-Border Adopting Release, the proposed amendment includes "arrange" instead of "solicit" in recognition of the fact that a dealer, by virtue of being commonly known in the trade as a dealer, may respond to requests by counterparties to enter into dealing transactions, in addition to actively seeking out such counterparties. See Cross-Border Adopting Release, 79 FR 47322 n.381; 15 U.S.C. 78c(a)(71)(A)(iv). Similarly, the proposed amendment omits reference to where a transaction is booked because, in determining whether dealing activity involving two non-U.S.-person counterparties occurs within the United States, we preliminarily believe it is appropriate to focus on the location of the market-facing activity of personnel arranging, negotiating, or executing the security-based swap on behalf of a non-U.S. person in connection with its security-based swap dealing activity, as it is the market-facing activity that raises the types of concerns described above. Cf. note 115, supra. If the transaction is booked in a U.S. person, of course, that U.S. person is a counterparty to the security-based swap and is required to include the security-based swap in its own de minimis calculation if the transaction is in connection with its dealing activity. See Exchange Act rule 3a71-3(b)(1)(i).

174 In other words, sales and trading personnel of a non-U.S. person who are located in the United States cannot simply direct other personnel in carrying out dealing activity that those personnel would otherwise carry out were those personnel not attempting to avoid application of this rule.

175 See note 115, supra.

176 See, e.g., notes 127 and 129, supra.

by market participants, and therefore as unworkable on a trade-by-trade basis.[177] In response, we clarify that under this proposed amendment, we do not intend market participants to look beyond those personnel who are involved in, or directing, market-facing activity in connection with a particular security-based swap. This should enable market participants to identify the location of relevant activity more efficiently than a test that would require market participants to categorize personnel according to their functions. The proposed amendment would require such market participants to focus on whether sales or trading personnel located in the United States engage in this market-facing activity in connection with a particular transaction, not on where these or other personnel perform internal functions (such as the processing of trades or other back-office activities) in connection with that transaction.[178] Accordingly, the involvement of personnel located in a U.S. branch or office in a transaction, where such personnel do not engage in market-facing activities with respect to a specific transaction (such as a person who designs the security-based swap but does not communicate with the counterparty regarding the contract in connection with a specific transaction and does not execute trades in the contract) would not fall within the scope of the proposed amendment.[179] Accordingly, preparing underlying

[177] See notes 127 and 129, supra. See also notes 107, 112, and 135, supra.

[178] One commenter urged the CFTC to exclude from Title VII requirements any transaction executed electronically. See note 130, supra (citing Barclays Letter to CFTC). However, we do not think that such an exclusion would be appropriate under our proposed approach given its focus on, among other things, the location of personnel executing the transaction on behalf of the non-U.S. person. To the extent that a non-U.S. person is using personnel located in the United States to execute a security-based swap transaction, that transaction raises regulatory concerns that, at sufficient volumes, warrant regulation under Title VII. In particular, we note that electronic execution does not eliminate concerns about abusive or manipulative conduct. See also Section III.C, infra (discussing proposal to make exception for cleared anonymous transactions unavailable for security-based swaps arranged, negotiated, or executed by personnel located in the United States).

[179] See note 104, supra (citing IIB Letter arguing that ministerial or clerical activity in the United States should not trigger application of Title VII). On the other hand, to the extent that personnel located in a U.S. branch or office engages in market-facing activity normally associated with

documentation for the transaction, including negotiation of a master agreement and related documentation, or performing ministerial or clerical tasks in connection with the transaction as opposed to negotiating with the counterparty the specific economic terms of a particular security-based swap transaction, also would not be encompassed by the proposed approach. We preliminarily believe that activities in the United States that do not involve the arrangement or negotiation of the economic terms of a specific transaction are unlikely to raise the types of concerns addressed by the Title VII requirements that we are proposing to apply to such transactions.[180] Consistent with customary Commission practice, we expect that Commission staff will monitor the practices of market participants as they develop under any final rules that we adopt and, if necessary and appropriate, make recommendations to address such developments.

We preliminarily believe that our proposed amendment should considerably mitigate concerns raised by commenters regarding the scope and workability of an activity-based test for

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sales and trading, the location of that personnel would be relevant, even if the personnel are not formally designated as sales persons or traders.

180 Similarly, a transaction would not be captured under the proposed amendment merely because a U.S.-based attorney is involved in negotiations regarding the terms of the transaction.

We also are not proposing to include either submitting a transaction for clearing in the United States or reporting a transaction to an SDR in the United States as activity that would cause a transaction to be arranged, negotiated, or executed by personnel located in the United States under the proposed rule, nor are we proposing to treat activities related to collateral management (*e.g.*, exchange of margin payments) that may occur in the United States or involve U.S. banks or custodians as activity conducted within the United States for these purposes. We recognize that submission of a transaction for clearing to a CCP located in the United States poses risk to the U.S. financial system, and collateral management plays a vital role in an entity's financial responsibility program and risk management. However, we preliminarily believe that none of these activities, by themselves, would raise the types of concerns associated with dealing activity. See Cross-Border Proposing Release, 78 FR 31000. Cf. note 116, supra (citing comment letter urging that application of Title VII not be triggered by the location at which a transaction is cleared).

application of Title VII requirements.[181] Because the proposed amendment requires a non-U.S. person to include a security-based swap in its de minimis calculation based solely on where it (and not its counterparty) arranges, negotiates, or executes the security-based swap, a non-U.S. person that is acting in a dealing capacity in a particular transaction would need to identify the location of its personnel (or that of its agent's personnel) involved in market-facing activity with respect to the transaction, but not the location of its counterparty.[182]

Some commenters urged that an activity-based test, if implemented, should look only to where the relevant transaction was executed, or where the dealer's personnel committed the dealer to the trade.[183] Although we recognize that focusing solely on where a security-based swap was executed (and not where it was arranged or negotiated) may meaningfully reduce certain costs associated with the proposed amendment, we preliminarily believe that looking solely to the location of execution could permit non-U.S. persons engaged in security-based swap dealing activity using personnel located in a U.S. branch or office to avoid falling within the definition of "security-based swap dealer" simply by ensuring that execution is performed by personnel located outside the United States, even if the non-U.S. person uses personnel located

181 See, e.g., notes 108-110 and 115, supra.

182 One commenter supported the initially proposed term "transaction conducted within the United States" in part because the commenter believed that it would help capture offshore funds with a "U.S. nexus," given that it would have encompassed all security-based swap trading activity carried out by investment managers within the United States. See note 26, supra (citing Citadel Letter). Under the narrower scope of activity captured in our proposed amendment, such activity of a person not engaged in dealing activity would not require the transaction to be included in the de minimis threshold calculation of its dealer counterparty. We note, however, that our rule defining "principal place of business in the United States" as applied to externally managed investment vehicles should help ensure that those funds whose security-based swap activities may pose risks to U.S. financial institutions, even when transacting with non-U.S. dealers, are treated as U.S. persons. See Exchange Act rule 3a71-3(a)(4)(ii); Cross-Border Adopting Release, 79 FR 47310.

183 See notes 129-130, supra.

in a U.S. branch or office to perform all other key aspects of its dealing activity. We also note that the "security-based swap dealer" definition encompasses a number of activities, including holding oneself out as a dealer or market-making,[184] which suggests that it is appropriate to focus on the location of a wider range of market-facing activity.

(b) "Located in a U.S. branch or office"

Proposed rule 3a71-3(b)(1)(iii)(C) would apply only to transactions connected with a non-U.S. person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel located in a U.S. branch or office.[185] This element of the proposed amendment should mitigate the likelihood, noted by several commenters,[186] that a non-U.S.-person dealer would be required to include in its de minimis calculations transactions that involve activity by personnel of the non-U.S. person or personnel of its agent who are not assigned to a U.S. branch or office, but instead are only incidentally present in the United States when they arrange, negotiate, or execute the transaction. The proposed amendment generally would not require a non-U.S. person to consider activity of personnel who are not located in a U.S. branch or office, such as participation in negotiations of the terms of a security-based swap by an employee of the

184 See Exchange Act section 3(a)(71)(A)(ii); Intermediary Definitions Adopting Release, 77 FR 30617-18.

185 As noted above, however, if personnel located in a non-U.S. branch or office are arranging, negotiating, or executing a particular security-based swap at the specific direction (i.e., engaging in dealing activity of the U.S. person that the U.S. person would carry out itself were it not attempting to avoid Title VII) of personnel located in a U.S. branch or office, we would view that transaction as having been arranged, negotiated, or executed by the personnel located in the United States. See note 174 and accompanying text, supra.

186 See note 104, supra (citing comments expressing concern that the initially proposed definition of "transaction conducted within the United States" would capture incidental conduct within the United States).

dealer assigned to a foreign office who happens to be traveling within the United States.[187] We preliminarily believe that this type of activity is incidental and therefore not likely to raise the concerns that the proposed approach is intended to address to the same degree as dealing activity carried out by personnel who are located in a U.S. branch or office.[188]

The proposed amendment would, however, not exclude security-based swap transactions that the non-U.S. person, in connection with its dealing activity, arranges, negotiates, or executes, using personnel located in a U.S. branch or office to respond to inquiries from a non-U.S.-person counterparty outside business hours in the counterparty's jurisdiction. We preliminarily believe that a non-U.S. person that uses sales or trading personnel located in a U.S. branch or office to engage in market-facing activity in connection with its dealing activity is likely to raise Title VII concerns, regardless of either counterparty's motivations for entering into the transaction.[189] Accordingly, we preliminarily do not believe that it would be appropriate to exclude from the de minimis calculation transactions arising from such activity by personnel located in a U.S. branch or office because their assignment to a U.S. branch or office suggests that the presence of such personnel in the United States is not "incidental."

We preliminarily believe that this element of the proposed amendment also should mitigate the burdens associated with determining whether a particular transaction needs to be

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187 Because proposed Exchange Act rule 3a71-3(b)(1)(iii)(C) applies only to the security-based swap dealing activity, it does not limit, alter, or address any guidance regarding our views or interpretation of any similar provisions of the federal securities laws, including those applicable to brokers or dealers under the Exchange Act, or investment advisers under the Investment Advisers Act of 1940, Commission rules, regulations, interpretations, or guidance.

188 See Section III.B.4, supra.

189 One commenter described these transactions as being carried out on an "exception basis." See IIB Letter to CFTC at 12. See also note 143, supra. Other commenters urged us not to use "incidental" activity in the United States to trigger application of Title VII or suggested that we establish a materiality threshold. See note 104, supra (citing MFA/AIMA Letter and SIFMA/FIA/FSR Letter).

included in a non-U.S. person's de minimis calculation.[190] We acknowledge that the proposed amendment potentially would lead a market participant to perform a trade-by-trade analysis to determine the location of relevant personnel performing market-facing activity in connection with the transaction. However, because the proposed amendment encompasses a person's dealing activity only when its personnel or personnel of its agent located in a U.S. branch or office have arranged, negotiated, or executed the transaction, a non-U.S. person performing this analysis should be able to identify for purposes of ongoing compliance the specific sales and trading personnel whose involvement in market-facing activity would require a transaction to be included in its de minimis calculation.[191] Alternatively, such non-U.S. person may establish policies and procedures that would facilitate compliance with this proposed amendment by requiring transactions connected with its dealing activity to be arranged, negotiated, and executed by personnel located outside the United States.[192]

(c) "Personnel of such non-U.S. person" or "personnel of an agent"

Proposed rule 3a71-3(b)(1)(iii)(C) would apply to transactions connected with a non-U.S. person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel located in a U.S. branch or office, whether the non-U.S. person arranges, negotiates, or executes the transaction directly using its own personnel located in a U.S. branch or office, or does so using personnel of an agent of such non-U.S. person, located in a U.S. branch or office.

190 See notes 108-110, and 133-134, supra.

191 We preliminarily believe that persons engaged in dealing activity may already identify personnel involved in market-facing activity with respect to specific transactions in connection with regulatory compliance policies and procedures and to facilitate compensation.

192 In addition, we note that some market participants engaged in both swap dealing and security-based swap dealing activity may perform a similar analysis consistent with CFTC Staff Advisory, which clarifies the CFTC staff's view that Title VII requirements apply to transactions arranged, negotiated, or executed in the United States by, or on behalf of, swap dealers. See notes 21 and 169, supra, and accompanying discussion.

As noted above, a non-U.S. person engaged in security-based swap dealing activity with other non-U.S. persons, if it wishes to avail itself of the expertise of sales, trading, and other personnel located in the United States, may carry out that activity using its own personnel located in a U.S. branch or office, or using the personnel of its agent, located in a U.S. branch or office.[193] We preliminarily believe that dealing activity carried out within the United States by a non-U.S. person is likely to raise the concerns that the proposed approach is intended to address,[194] whether that dealing activity is carried out by the non-U.S. person's personnel located in a U.S. branch or office or on its behalf by the personnel of its agent, located in a U.S. branch

193 For purposes of proposed rule 3a71-3(b)(1)(iii)(C), we would interpret the term "personnel" in a manner consistent with the definition of "associated person of a security-based swap dealer" contained in section 3(a)(70) of the Exchange Act, 15 U.S.C. 78c(a)(70), regardless of whether such non-U.S. person or such non-U.S. person's agent is itself a security-based swap dealer. This definition is, in turn, substantially similar to the definition of "associated person of a broker or dealer" in section 3(a)(18) of the Exchange Act, 15 U.S.C. 78c(a)(18). The definition in section 3(a)(18) is intended to encompass a broad range of relationships that can be used by firms to engage in and effect securities transactions, and is not dependent solely on whether a natural person is technically an "employee" of the entity in question. See Alexander C. Dill, Broker-Dealer Regulation Under the Securities Exchange Act of 1934: The Case of Independent Contracting, 1994 COLUM. BUS. L. REV. 189, 211-213 (1994) (noting that the Securities Act Amendments of 1964, which amended section 3(a)(18) of the Exchange Act, "rationalized and refined the concept of 'control' by firms over their sales force by introducing the concept of an 'associated person' of a broker-dealer."). Accordingly, we would expect to examine whether a particular entity is able to control or supervise the actions of an individual when determining whether such person is considered to be "personnel" of a U.S. branch, office, or agent of a security-based swap dealer. This is particularly relevant in the context of a financial group that engages in a security-based swap dealing business, where personnel of one affiliate may operate under the direction of, or in some cases, report to personnel of another affiliate within the group. See also Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, BHCA-1 (Dec. 10, 2013), 59 FR 5535, 5591 (Jan. 31, 2014) (explaining, in the context of adopting certain provisions of what is commonly referred to as the Volcker Rule, that the relevant "trading desk" of a banking entity "may manage a financial exposure that includes positions in different affiliated legal entities" and similarly "may include employees working on behalf of multiple affiliated legal entities or booking trades in multiple affiliated entities") (internal citations omitted).

194 See Section III.B.4, supra.

or office.[195] Accordingly, we are proposing to require non-U.S. persons to include in their de minimis calculations any transactions in connection with their security-based swap dealing activity that are arranged, negotiated, or executed by personnel of such persons located in a U.S. branch or office, or by personnel of its agent located in a U.S. branch or office.[196]

We considered the view of at least one commenter that our existing broker-dealer regime would be sufficient to address any concerns raised by personnel of its agent in the United States acting on behalf of a non-U.S. person engaged in security-based swap dealing activity.[197] Because the Exchange Act defines security-based swaps as securities, an agent acting on behalf of a non-U.S. person that is engaged in security-based swap dealing activity generally would be

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195 We preliminarily believe that it is appropriate for the proposed amendment to take into account where personnel of the non-U.S. person's agent are arranging, negotiating, or executing the transaction on behalf of the non-U.S. person, regardless of whether the agent is affiliated with the non-U.S. person, as security-based swap dealing activity carried out through an unaffiliated agent may raise the same concerns as such activity carried out through an affiliated agent. See note 164, supra.

196 Two commenters raised concerns that our initially proposed rule could put U.S. brokers and investment managers at a competitive disadvantage by subjecting all security-based swap transactions in which they are involved, including those in which they are performing services on behalf of non-U.S. persons, to the relevant provisions of Title VII under the initially proposed definition of "transaction conducted within the United States." See note 113, supra (citing IIB Letter and SIFMA/FIA/FSR Letter); note 104, supra (citing Pensions Europe Letter, IAA Letter, and ICI Letter). The re-proposed approach should mitigate this concern on the part of investment managers, as proposed Exchange Act rule 3a71-3(b)(1)(iii)(C) would look only to the location of the dealing counterparty's activity, meaning that the location of the investment adviser will be immaterial to its dealing counterparty's de minimis calculation under the proposed amendment. This approach would also address concerns expressed by one commenter that private funds may have difficulty identifying whether their dealer counterparties are engaged in dealing activity in the United States. See note 106, supra.

However, under the proposed approach a non-U.S. person that uses a broker as its agent to arrange, negotiate, or execute security-based swap transactions in connection with that non-U.S. person's dealing activity would be required to include those transactions in its own de minimis calculations. We recognize that this approach may make certain brokers less able to compete for the business of non-U.S.-person dealers that would otherwise not be arranging, negotiating, or executing transactions using personnel located in a U.S. branch or office, but given the regulatory concerns such transactions may raise, we think it is appropriate to require such transactions to be included in the non-U.S. person's de minimis threshold calculations. See Section III.B.4, supra.

197 See IIB Letter at 10.

required to register as a broker and, with respect to the transactions that it intermediates, could be required to comply with relevant Exchange Act requirements with respect to those transactions.[198] The commenter suggested that direct regulation of this agent would address "most of the . . . objectives to be served by [security-based swap dealer] registration, as well as the external business conduct standards."[199]

After careful consideration of this alternative approach, we have preliminarily concluded that broker-dealer regulation would not, on its own, adequately address the concerns raised by agents located in the United States acting on behalf of non-U.S. persons to facilitate the security-based swap dealing activity of such non-U.S. persons. Given the range of regulatory concerns such activity raises,[200] we preliminarily believe that, irrespective of any other regulatory framework that may apply to the agent, the non-U.S. person engaged in security-based swap

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198 Title VII of the Dodd-Frank Act amended the Exchange Act definition of "security" to encompass security-based swaps. See Exchange Act section 3(a)(10), 15 U.S.C. 78c(a)(10), as revised by section 761(a)(2) of the Dodd-Frank Act. See also Exchange Act section 3(a)(4) (defining "broker"). We previously granted temporary exemptive relief from compliance with certain provisions of the Exchange Act in connection with this revision of the statutory requirements in order generally to maintain the status quo during the implementation process for the Dodd-Frank Act. See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revisions of the Definition of "Security" to Encompass Security-Based Swaps, Exchange Act Release No. 64795 (Jul. 1, 2011), 76 FR 39927 (Jul. 7, 2011) ("Exchange Act Exemptive Order"). Among other things, this relief granted temporary exemptions specific to security-based swap activities by registered brokers and dealers. See id. at 39-44. In February 2014, we extended the expiration dates (1) for exemptions that are generally not directly related to specific security-based swap rulemakings until the earlier of such time that we issue an order or rule determining whether any continuing exemptive relief is appropriate for security-based swap activities with respect to any of the Exchange Act provisions or until three years following the effective date of that order; and (2) for exemptions that are directly related to specific security-based swap rulemakings, until the compliance date for the relevant security-based swap rulemaking. See 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 (February 5, 2014), 79 FR 7731 (February 10, 2014).

199 IIB Letter at 10.

200 See Section III.B.4, supra.

dealing activity through the agent, if it exceeds the de minimis threshold, should also be subject to security-based swap dealer regulation.[201]

First, as that commenter acknowledged, an agent using personnel located in a U.S. branch or office would not be required to register as a broker-dealer if it could avail itself of certain exceptions under the Exchange Act and the rules or regulations thereunder.[202] Given these exceptions, reliance on the broker-dealer regime to address the regulatory concerns raised by security-based swap dealing activity that a non-U.S. person carries out in the United States through an agent could result in significant non-U.S. person security-based swap dealing activity being carried out using an agent that, because, for example, it is a bank, is not in fact subject to the broker-dealer regulatory framework. We preliminarily believe that this result would not be appropriate, particularly given that, in Title VII, Congress established a new, separate regulatory framework for security-based swap dealers that was designed specifically to encompass the security-based swap dealing activities of banks.[203]

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201 Consistent with our views expressed in prior releases, if a financial group used one entity to perform the sales and trading functions of its dealing business and another to book the resulting transactions, we would "view the booking entity, and not the intermediary that acts as an agent on behalf of the booking entity to originate the transaction, as the dealing entity." Cross-Border Proposing Release, 78 FR 30976. See also Intermediary Definitions Adopting Release, 77 FR 30617 n.264 ("A sales force, however, is not a prerequisite to a person being a security-based swap dealer. For example, a person that engages in dealing activity can fall within the dealer definition even if it uses an affiliated entity to market and/or negotiate those security-based swaps connected with its dealing activity (e.g., the person is a booking entity)."). To the extent that the activities performed by the first person involve arrangement, negotiation, or execution of security-based swaps as agent for the booking entity engaged in dealing activity, our proposed amendment would treat the booking entity's transmission of an order and instructions to the agent as part of the dealing activity of the booking entity itself. As already noted, a person engaged in these activities on behalf of the security-based swap dealer may itself be subject to regulation as a broker under the Exchange Act. See note 198, supra.

202 See note 105, supra (citing IIB Letter). For example, Exchange Act section 3(a)(4)(B) excepts banks from the definition of "broker" with respect to certain activity.

203 See Exchange Act section 15F. Notably, the definition of "security-based swap dealer," unlike the definitions of "broker" and "dealer" under the Exchange Act, does not include any exceptions

Second, even absent the bank exception to the definition of "broker," we are not persuaded that broker-dealer regulation of the agent operating in the United States would address the concerns raised by this security-based swap dealing activity. For example, although regulation of the agent acting as a broker would provide the Commission with access to the books and records of the agent relating to a particular transaction, it would not provide us access to the relevant books and records of the non-U.S.-person dealer on whose behalf the agent is acting, which likely would reduce our ability to monitor that non-U.S. person engaging in the dealing activity for compliance with the securities laws, including with the anti-fraud provisions of those laws.[204]

As noted above, access to books and records is the primary tool for oversight of the financial entity and for conducting market surveillance. But the broker's books and records are likely to be insufficient for this purpose, given that foreign dealers may allocate different duties in connection with a particular security-based swap to their own personnel and other functions to their agents, both in and outside the United States. The records of the agents would not be sufficient to document other market-facing activity of the foreign dealer that is not carried out through the agent, but that may be relevant to identifying activity in the United States both within the security-based swap market as well as in markets for related underlying assets, such as corporate bonds, that, in light of the other security-based swap activity of the foreign dealer, may be abusive or manipulative. We would have access to these books and records necessary to identify fraudulent or abusive conduct on the part of the foreign dealer only if the foreign dealer is required to register as a security-based swap dealer. In addition, identifying certain

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for banks or banking activities. See Exchange Act section 3(a)(71) (defining "security-based swap dealer").

204 See Section III.B.4, supra.

manipulative or abusive market practices may require information about security-based swap transactions of the non-U.S.-person dealer that are not arranged, negotiated, or executed in the United States. To effectively monitor for fraud and manipulation in a market where a significant proportion of transactions are likely to be carried out by (and between) dealers using these types of business structures, we preliminarily believe that the non-U.S.-person dealers that are the counterparties to these transactions should be required to include these transactions in their de minimis calculations. To the extent that they exceed the relevant thresholds, these dealers would be subject to security-based swap dealer regulation, which would enable the Commission to obtain access to the dealer's books and records.

6. Other commenter concerns and alternatives

(a) Potential duplication and comity concerns

Some commenters expressed concern that an activity-based approach to the de minimis exception and other Title VII requirements could lead to regulatory conflicts and overlaps,[205] or that it does not adequately take into account the actions and interests of other regulators.[206] As we noted above, Commission staff has participated in numerous bilateral and multilateral discussions with foreign regulatory authorities addressing the regulation of OTC derivatives, and, through these discussions, we have gathered information about foreign regulatory reform efforts and their impact on and relationship with the U.S. regulatory regime.[207]

We recognize that some non-U.S. persons that may be required to register as security-based swap dealers as a result of proposed Exchange Act rule 3a71-3(b)(1)(iii)(C) may already be subject to regulation similar to our security-based swap dealer regulatory framework in other

205 See note 105, supra.

206 See note 295, infra.

207 See Section I.B, supra.

jurisdictions. At the same time, we preliminarily believe that it is appropriate to regulate dealing activity that occurs within the United States, including by subjecting to security-based swap dealer registration non-U.S. persons that exceed the relevant de minimis threshold by virtue of security-based swap dealing activity involving the arrangement, negotiation, or execution of security-based swaps on behalf of such person by personnel located in a U.S. branch or office.[208] We previously have proposed to provide the opportunity for substituted compliance with respect to certain security-based swap dealer requirements as set forth in our Cross-Border Proposing Release.[209] We received comments on this proposal, which we continue to consider, and we continue preliminarily to believe that the appropriate means of addressing potential overlap or duplication is through substituted compliance rather than by forgoing regulation entirely.[210]

(b) Reliance on representations

At least one commenter specifically requested that we retain the provision in the proposal permitting reliance on a representation concerning whether a counterparty was engaging in

208 As noted above, one commenter specifically argued that the initially proposed approach would subject U.S. branches of EU banks to duplicative regulations because EU regulations also apply to the transactions of such branches. See note 105, supra. We do not believe the possibility that a person may be subject to similar regulation by a foreign regulatory authority can be determinative of the scope of our regulatory framework, given the specific authority Congress provided us to regulate, among other things, security-based swap dealing activity in the United States and given the potential for differences in regulatory interests and in supervisory and enforcement priorities among different regulatory jurisdictions. We also note that EU regulations similarly apply to transactions between two EU branches of U.S. banks. See Commission Delegated Regulation supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 with regard to regulatory technical standards on direct, substantial and foreseeable effect of contracts within the Union and to prevent the evasion of rules and obligations, Article 2(1).

209 See Cross-Border Proposing Release, 78 FR 31088-90 (discussing proposed substituted compliance framework for security-based swap dealers); id. at 31024-25 (same).

210 See Cross-Border Proposing Release, 78 FR 31088-90 (describing proposed substituted compliance framework for foreign security-based swap dealers); initially proposed Exchange Act rule 3a71-5 (providing for substituted compliance with respect to security-based swap dealer requirements).

activity within the United States.[211] The proposed amendment does not incorporate such a provision, as the more limited scope of the re-proposed rule appears to make it unnecessary in this context. The proposed rule would focus solely on the conduct of a non-U.S. person acting in a dealing capacity, and only that person is required to account for such activity in its de minimis calculations. Accordingly, whether one counterparty's dealing activity occurs within or outside the United States has no legal effect on the obligations of the other counterparty under the proposed rule, and the location of the other counterparty has no effect on whether the transaction falls within the scope of the proposed rule.[212]

7. Request for comment

We request comment on all aspects of the discussion and analysis above, including the following:

- Is our understanding of the global nature of the security-based swap market accurate? If not, why not?
- Is our understanding of the dealing structures used by U.S. and non-U.S. persons accurate? If not, why not? Are there other dealing structures used by market participants?
- Is our understanding of the use of affiliated or unaffiliated persons, such as registered broker-dealers in the United States (including inter-dealer brokers) accurate? If not, why not?

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211 See note 117, supra.

212 Also for this reason, the re-proposed approach addresses comments regarding potential difficulties private funds may have in obtaining such representations from their dealer counterparties. See id. (citing MFA/AIMA Letter). See also note 106, supra.

- Should a non-U.S. person that engages in dealing activity with other non-U.S. persons be required to consider, for purposes of counting a transaction towards its de minimis calculation, the location of its counterparty's dealing activity in addition to the location of its own or its agent's dealing activity? Would the proposed amendment requiring such a non-U.S. person to consider only the location of its own dealing activity appropriately mitigate commenters' concerns while also ensuring that a non-U.S. person that engages in significant levels of dealing activity using personnel located in the United States would be subject to regulation as a security-based swap dealer?
- Does proposed rule 3a71-3(b)(1)(iii)(C), which would apply only to transactions connected with a non-U.S. person's security-based swap dealing activity that it (or its agent) arranges, negotiates, or executes using personnel located in a U.S. branch or office, appropriately focus on activity that is likely to raise the types of concern addressed by Title VII? Is it appropriate to generally focus on market-facing activities? Is the scope of activities too narrow or too broad? Why? Will the approach be workable for market participants? Why or why not?
- Is the use of the terms "arrange," "negotiate," and "execute" in the release and rule text sufficiently clear? How could the terms be further clarified if necessary?
- Is the focus on market-facing activities of the sales and trading desks appropriate in identifying transactions between two non-U.S. persons that should be subject to Title VII requirements?
- Does the change to proposed rule 3a71-3(b)(1)(iii)(C) that would require transactions to be included in a person's de minimis calculation only if personnel

arranging, negotiating, or executing the security-based swap are "located in a U.S. branch or office" address the type of activity within the United States that is likely to raise concerns under Title VII? Is the approach too narrow or too broad? Why?

- Should the proposed amendment incorporate an exception from security-based swap dealer regulation for a non-U.S. person that arranges, negotiates, or executes transactions using personnel of its agent located in a U.S. branch or office to the extent that the agent is a registered broker-dealer? If so, how should this dealing activity be regulated? Specifically, to the extent that security-based swap brokering activity is carried out by personnel of the non-U.S. person engaged in dealing activity who are located in a U.S. branch or office, how should we address it? To the extent that security-based swap brokering activity is carried out by a bank, how should we regulate it? How would we obtain access to the books and records for transactions outside the United States of an unregistered dealer also doing business in the United States through a broker to monitor for market manipulation or other abusive practices?
- Do you agree with proposed rule 3a71-3(b)(1)(iii)(C), which requires a non-U.S. person to include in its de minimis calculation, transactions that it arranges, negotiates, or executes using personnel of an affiliated agent of such non-U.S. person located in a U.S. branch or office?
- Do you agree with proposed rule 3a71-3(b)(1)(iii)(C), which requires a non-U.S. person to include in its de minimis calculation, transactions that it arranges,

negotiates, or executes using personnel of an unaffiliated agent of such non-U.S. person located in a U.S. branch or office?

- What types of controls would be necessary to ensure that a non-U.S. person engaged in dealing activity counts transactions that it is required to include in its dealer de minimis calculations under proposed rule 3a71-3(b)(1)(iii)(C)? How would this work as an operational matter?
- Is this proposed approach to applying Title VII to transactions connected with a non-U.S. person's security-based swap dealing activity that it (or its agent) arranges, negotiates, or executed using personnel located in a U.S. office workable in light of the approach set forth in the CFTC Staff Advisory? Why or why not?

C. Availability of the Exception for Cleared Anonymous Transactions

1. Proposed rule

Under Exchange Act rule 3a71-5, a non-U.S. person, other than a conduit affiliate, is not required to include in its de minimis calculation "transactions that are entered into anonymously on an execution facility or national securities exchange and are cleared through a clearing agency."[213] As we noted in the Cross-Border Adopting Release, this rule is intended to avoid putting market participants in a position where they are required to determine the treatment of the transaction under the de minimis exception in circumstances where the information necessary to that determination (e.g., the U.S.-person status of the counterparty) is unavailable to them.[214] We also noted that, absent such an exception, execution facilities outside the United States might

[213] Exchange Act rule 3a71-5.

[214] See Cross-Border Adopting Release, 79 FR 47325 n.412.

determine to exclude U.S. market participants to prevent a non-U.S. market participant from potentially being required to register as a security-based swap dealer based on information unavailable to the non-U.S. market participant at the time of the transaction.[215]

We are proposing to amend rule 3a71-5 by adding new paragraph (c) to make this exception unavailable to transactions that non-U.S. persons would be required to count under proposed Exchange Act rule 3a71-3(b)(1)(iii)(C). We preliminarily believe that excepting such transactions would be inconsistent with the purposes underlying the requirement that a non-U.S. person include transactions arranged, negotiated, or executed by personnel located in a U.S. branch or office in connection with its dealing activity in its de minimis calculations. To the extent that a non-U.S. person is, in connection with its dealing activity, arranging, negotiating, or executing security-based swap transactions using personnel located in a U.S. branch or office, it raises the concerns described above,[216] regardless of whether such transactions are entered into over-the-counter or on an SB SEF or national securities exchange. Requiring a non-U.S. person to include these transactions in its dealer de minimis calculations does not appear to raise the concerns that led us to adopt Exchange Act rule 3a71-5, given that proposed Exchange Act rule 3a71-3(b)(1)(iii)(C) requires the non-U.S. person to look only to the location of its own security-based swap dealing activity in determining whether it is required to count the trade against its de minimis threshold. Finally, as with disparities in the application of Title VII to transactions arranged, negotiated, or executed in the United States more generally,[217] we note that, if a non-U.S. person could avail itself of this exception even when arranging, negotiating, or executing a

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215 See Cross-Border Adopting Release, 79 FR 47325.

216 See Section III.B.4, supra.

217 See Section II.A, supra (discussing competitive effects of disparate regulatory treatment of activity in the United States); notes 114 and 138, supra (citing comment letters expressing concern about potential competitive disparities).

transaction in connection with its dealing activity using personnel located in a U.S. branch or office, it could have a significant competitive advantage over U.S. persons, even with respect to transactions that are executed on an SB SEF or national securities exchange and cleared on a clearing agency located in the United States.

2. Request for comment

We request comment on all aspects of the proposed amendment regarding availability of the exception for cleared, anonymous transactions with respect to identifying security-based swap transactions that do not need to be included in the de minimis threshold calculations of non-U.S. persons, including the following:

- With respect to transactions that a non-U.S. person would be required to count under proposed rule 3a71-3(b)(1)(iii)(C), should there be an exception from counting such transactions if they are entered into anonymously on an SB SEF or national securities exchange and are cleared through a clearing agency? Why or why not?
- Do security-based swap transactions entered into anonymously on an SB SEF or national securities exchange and cleared through a clearing agency mitigate the risk of fraud or market abuse or other concerns with respect to transactions between two non-U.S. persons that are arranged, negotiated, or executed by personnel located in a U.S. branch or office? Why or why not?

IV. Application of the External Business Conduct Requirements to the Foreign Business and U.S. Business of Registered Security-Based Swap Dealers

A. Overview

In the Cross-Border Proposing Release, we proposed an approach to the application of the security-based swap dealer requirements set forth in section 15F of the Exchange Act that would classify each of these requirements either as entity-level requirements, which apply to the dealing entity as a whole, or as transaction-level requirements, which apply to specific transactions. In this taxonomy, entity-level requirements include requirements relating to capital and margin, risk management procedures, recordkeeping and reporting, supervision, and designation of a chief compliance officer.[218] Transaction-level requirements include, among others, requirements relating to external business conduct and segregation, which are intended primarily to protect counterparties by requiring registered security-based swap dealers to, among other things, provide certain disclosures to counterparties, adhere to certain standards of business conduct, and segregate customer funds, securities, and other assets.[219]

We proposed generally to apply all requirements in section 15F of the Exchange Act, and the rules and regulations thereunder, to both registered U.S. and foreign security-based swap dealers.[220] We also proposed to establish a policy and procedural framework under which we would consider permitting substituted compliance for registered foreign security-based swap dealers under certain circumstances (but not for registered U.S. security-based swap dealers).[221] We proposed, however, to except the foreign business of registered security-based swap dealers from the external business conduct requirements.[222]

We are re-proposing this exception, which, as originally proposed, incorporated the term "transaction conducted within the United States," to reflect the re-proposed approach to identifying relevant security-based swap activity of registered foreign security-based swap

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218 See Cross-Border Proposing Release, 78 FR 31009.

219 See id.

220 See id.

221 See id. at 31088.

222 See id. at 31016.

dealers that they carry out using personnel located in the United States. We continue to believe that the foreign business of registered security-based swap dealers should be excepted from the external business conduct requirements of Title VII. We also preliminarily believe that it is desirable that the types of activities in the United States that trigger application of the external business conduct requirements to transactions of a registered foreign security-based swap dealer with another non-U.S. person should be identical to those that require a transaction to be included in a non-U.S. person's de minimis threshold calculations, as a consistent test should be more workable for market participants to implement and we preliminarily believe that the proposed test captures the activity that is likely to raise concerns about business conduct in the United States. Accordingly, we are re-proposing initially proposed Exchange Act rule 3a71-3(c) and related definitions solely to conform to the proposed amendments to the de minimis exception.[223]

B. Statutory Framework for External Business Conduct

Section 15F(h) of the Exchange Act requires the Commission to adopt rules specifying external business conduct standards for registered security-based swap dealers in their dealings with counterparties,[224] including counterparties that are "special entities."[225] Congress granted

223 This proposal does not address application of any of the other elements of the Title VII security-based swap dealer requirements described in the Cross-Border Proposing Release, including those related to the application of entity-level requirements to security-based swap dealers; the application of segregation requirements under Exchange Act section 3E, and the rules and regulations thereunder; and the availability of the opportunity for substituted compliance (including initially proposed Exchange Act rule 3a71-5, which set forth, among other things, the process for submitting substituted compliance determination requests and the standard we would use in evaluating those requests). We anticipate addressing the comments on these elements of that proposal in the context of our consideration of final rules regarding each of the respective security-based swap dealer requirements.

224 Exchange Act section 15F(h)(6), 15 U.S.C. 78o-10(h)(6), directs the Commission to prescribe rules governing external business conduct standards for security-based swap dealers.

the Commission broad authority to promulgate business conduct standards that the Commission determines to be appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.[226]

These standards, as described in section 15F(h)(3) of the Exchange Act, must require security-based swap dealers to: (i) verify that a counterparty meets the eligibility standards for an eligible contract participant; (ii) disclose to the counterparty material information about the security-based swap, including material risks and characteristics of the security-based swap, and material incentives and conflicts of interest of the security-based swap dealer in connection with the security-based swap; and (iii) provide the counterparty with information concerning the daily mark for the security-based swap. Section 15F(h)(3) also directs the Commission to establish a duty for security-based swap dealers to communicate information in a fair and balanced manner based on principles of fair dealing and good faith and to establish other standards as the Commission determines are in furtherance of the purposes of the Exchange Act.

In addition, section 15F(h)(4) of the Exchange Act requires that a security-based swap dealer that "acts as an advisor to a special entity" must act in the "best interests" of the special entity and undertake "reasonable efforts to obtain such information as is necessary to make a reasonable determination" that a recommended security-based swap is in the best interests of the

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225 Exchange Act section 15F(h)(2)(C), 15 U.S.C. 78o-10(h)(2)(C) (defining "special entities"). As discussed below, we have previously proposed business conduct rules and continue to consider comments received on that proposal. See IV.C.1, infra. We intend to address these comments in a subsequent adopting release finalizing rules establishing external business conduct standards, including provisions applicable in transactions with "special entities."

226 See Exchange Act section 15F(h)(3)(D), 15 U.S.C. 78o-10(h)(3)(D) ("[b]usiness conduct requirements adopted by the Commission shall establish such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act"). See also Exchange Act section 15F(h)(1)(D) (requiring security-based swap dealers to comply with "such business conduct standards . . . as may be prescribed by the Commission by rule or regulation that relate to . . . such other matters as the Commission determines to be appropriate").

special entity.[227] Section 15F(h)(5) requires that a security-based swap dealer that enters into, or offers to enter into, security-based swaps with a special entity comply with any duty established by the Commission that requires the security-based swap dealer to have a "reasonable basis" for believing that the special entity has an "independent representative" that meets certain criteria and undertakes a duty to act in the "best interests" of the special entity.

C. Prior Proposals

1. Business Conduct Proposal

We have proposed rules 15Fh-1 through 15Fh-6 under the Exchange Act to implement the business conduct requirements described above.[228] In addition to external business conduct standards expressly addressed by Title VII, we have proposed certain other business conduct requirements for security-based swap dealers that we preliminarily believed would further the principles that underlie the Dodd-Frank Act. These rules would, among other things, impose certain "know your counterparty" and suitability obligations on security-based swap dealers, as well as restrict security-based swap dealers from engaging in certain "pay to play" activities and provide certain protections for "special entities."[229]

2. Cross-Border Proposing Release

In the Cross-Border Proposing Release, we proposed a rule that would have provided that a registered foreign security-based swap dealer and a foreign branch of a registered U.S. security-based swap dealer, with respect to their foreign business, shall not be subject to the

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227 See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants ("Business Conduct Proposal"), Exchange Act Release No. 64766 (June 29, 2011), 76 FR 42423-25 (July 18, 2011).

228 See Business Conduct Proposal, 76 FR 42396.

229 See Business Conduct Proposal, 76 FR 42399-400; proposed Exchange Act rules 15Fh-3(e) ("know your counterparty"), 15Fh-3(f) ("suitability"), and 15Fh-6 ("pay to play").

requirements relating to external business conduct standards described in section 15F(h) of the Exchange Act,[230] and the rules and regulations thereunder, other than the rules and regulations prescribed by the Commission pursuant to section 15F(h)(1)(B).[231]

As described more fully in the Cross-Border Proposing Release, the proposed rule would have defined "U.S. business" and "foreign business" with respect to both foreign and U.S. security-based swap dealers. For a foreign security-based swap dealer, "U.S. business" would have been defined to mean (i) any transaction entered into, or offered to be entered into, by or on behalf of such foreign security-based swap dealer, with a U.S. person (other than with a foreign branch), or (ii) any transaction conducted within the United States.[232] For a U.S. security-based swap dealer, "U.S. business" would have been defined to mean any transaction by or on behalf of such U.S. security-based swap dealer, wherever entered into or offered to be entered into, other than a transaction conducted through a foreign branch with a non-U.S. person or another

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230 15 U.S.C. 78o-10(h).

231 See Cross-Border Proposing Release, 78 FR 31016. Section 15F(h)(1)(B) requires registered security-based swap dealers to conform with such business conduct standards relating to diligent supervision as the Commission shall prescribe. See 15 U.S.C. 78o-10(h)(1)(B). All other requirements in section 15F of the Exchange Act, and the rules and regulations thereunder, would apply to both U.S. and registered foreign security-based swap dealers, although we proposed to establish a framework under which we would consider permitting substituted compliance for foreign security-based swap dealers under certain circumstances (but not for U.S. security-based swap dealers, even when they conduct dealing activity through foreign branches). See id. The approach under the initially proposed rule would not have affected applicability of the general antifraud provisions of the federal securities laws to the activity of a foreign security-based swap dealer. See Cross-Border Proposing Release, 78 FR 31016 n.476.

232 See id. at 31016. Whether the activity in a transaction involving a registered foreign security-based swap dealer occurred within the United States or with a U.S. person for purposes of identifying whether security-based swap transactions are part of U.S. business would have turned on the same factors used in that proposal to determine whether a foreign security-based swap dealer is engaging in dealing activity within the United States or with U.S. persons and whether a U.S. person was conducting a transaction through a foreign branch, as set forth in that proposal. See id.

foreign branch of a U.S. person.[233] With respect to both a foreign security-based swap dealer and a U.S. security-based swap dealer, "foreign business" would have been defined to mean any security-based swap transactions entered into, or offered to be entered into, by or on behalf of the foreign security-based swap dealer or the U.S. security-based swap dealer that do not include its U.S. business.[234]

D. Comments

We received relatively few comments specifically addressing our initially proposed approach to application of the external business conduct requirements to security-based swap dealers. One commenter disagreed with our proposed approach with respect to U.S. security-based swap dealers, arguing that all transactions of such persons must always be subject to external business conduct standards, including those conducted through their foreign branches with non-U.S. persons and foreign branches of U.S. banks.[235]

Two commenters generally agreed with the initially proposed approach but suggested certain modifications to address specific concerns. One commenter generally agreed with the proposed approach that would not have imposed external business conduct requirements with respect to the "foreign business" of a foreign security-based swap dealer but argued that these requirements also should not apply to transactions with non-U.S. regulated funds whose security-based swap activity is managed by a U.S. asset manager.[236] This commenter argued that such funds would not expect to receive the protections of Title VII's business conduct standards merely because they use a U.S. asset manager and expressed concern that such requirements

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233 See id.

234 See id.

235 See Letter from Better Markets to SEC, dated August 21, 2013 ("Better Markets Letter") at 28.

236 See ICI Letter at 11.

would disadvantage these entities because foreign security-based swap dealers might prefer to transact with non-U.S. funds managed by non-U.S. asset managers to avoid compliance with the requirements.[237]

Another commenter argued that the definition of "U.S. business" should be limited to transactions with counterparties that are U.S. persons, and that this definition should apply to the business of U.S. and foreign security-based swap dealers.[238] This commenter argued that adopting a uniform definition of "U.S. business" and eliminating "transaction conducted within the United States" from that definition would better accord with the purpose of the requirements, with counterparty expectations, and with international comity concerns.[239] This commenter further stated that there was insufficient "jurisdictional nexus" to warrant applying the external business conduct requirements to all transactions conducted within the United States, regardless of the U.S.-person status of the counterparties.[240]

E. Discussion

We are re-proposing Exchange Act rule 3a71-3(c) regarding application of the external business conduct requirements, and proposing amendments to Exchange Act rule 3a71-3(a) to define certain terms to conform to the proposed amendments to Exchange Act rule 3a71-3(b)(1)(iii)(C), which identifies relevant security-based swap activity of registered foreign security-based swap dealers in which they engage using personnel located in the United States

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237 See id. This commenter suggested that we modify the proposed definition of "U.S. business" for foreign security-based swap dealers by removing prong (ii) of the initially proposed rule, which includes "any transactions conducted within the U.S." in the definition of "U.S. business." In this commenter's view, this change would help ensure that the transactions of such funds with registered foreign security-based swap dealers are not subject to the external business conduct requirements. See ICI Letter at 11 n.28 and accompanying text.

238 See SIFMA/FIA/FSR Letter at A-24.

239 See id. at A-24 to A-25.

240 See id. at A-25.

for purposes of the de minimis exception. Our general approach, however, remains unchanged: The re-proposed rule would distinguish between "U.S. business" and "foreign business" and except the foreign business of a registered foreign security-based swap dealer and a registered U.S. security-based swap dealer from the external business conduct standards in section 15F(h) and the rules and regulations thereunder (other than rules and requirements prescribed by the Commission pursuant to section 15F(h)(1)(B)) of the Exchange Act, and proposed amendments to Exchange Act rule 3a71-3(a) would incorporate these defined terms in the rule.[241]

Specifically, our re-proposed amendment to Exchange Act rule 3a71-3(a) would modify the initially proposed definition of "U.S. business" with respect to foreign security-based swap dealers to refer to any security-based swap transaction arranged, negotiated, or executed by personnel of the foreign security-based swap dealer located in a U.S. branch or office, or by personnel of its agent located in a U.S. branch or office.[242] The definition of "U.S. business" for

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241 See proposed Exchange Act rules 3a71-3(a)(6), (7), (8), and (9) (defining, respectively, "U.S. security-based swap dealer," "foreign security-based swap dealer," "U.S. business," and "foreign business"); re-proposed Exchange Act rule 3a71-3(c) (setting forth exceptions from certain external business conduct requirements with respect to the "foreign business" of registered foreign security-based swap dealers and registered U.S. security-based swap dealers).

This proposed approach to external business conduct standards would not except registered security-based swap dealers from the rules and requirements prescribed by the Commission pursuant to section 15F(h)(1)(B) of the Exchange Act with respect to their foreign business. As already noted, section 15F(h)(1)(B) requires registered security-based swap dealers to conform with such business conduct standards relating to diligent supervision as the Commission shall prescribe. See 15 U.S.C. 78o-10(h)(1)(B). We preliminarily believe that it is not appropriate to except registered security-based swap dealers from compliance with such requirements. Because registered security-based swap dealers would be subject to a number of obligations under the federal securities laws with respect to their security-based swap business, we preliminarily believe that having systems in place reasonably designed to ensure diligent supervision would be an important aspect of their compliance with the federal securities laws. Under our Cross-Border Proposing Release, these entity-level requirements would apply to a security-based swap dealer on a firm-wide basis to address risks to the security-based swap dealer as a whole. See Cross-Border Proposing Release, 78 FR 31011.

242 Proposed Exchange Act rule 3a71-3(a)(8)(i)(B). We intend the proposed rule to indicate the same type of activity by personnel located in the United States as described in Section III.B.5,

foreign security-based swap dealers and U.S. security-based swap dealers would continue to exclude certain transactions involving the foreign branches of U.S. persons.[243] The definitions of "U.S. security-based swap dealer,"[244] "foreign security-based swap dealer,"[245] and "foreign business"[246] would remain unchanged from the initial proposal, as would the text of re-proposed rule 3a71-3(c), which would create the exception to the external business conduct requirements (other than rules and requirements prescribed by the Commission pursuant to section 15F(h)(1)(B)) for the foreign business of registered security-based swap dealers.

We continue to believe that a registered security-based swap dealer should be required to comply with the external business conduct requirements with respect to its U.S. business. The proposed external business conduct standards are intended to bring professional standards of

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supra. Moreover, for purposes of proposed Exchange Act rule 3a71-3(a)(8)(i)(B), we would interpret the term "personnel" in a manner consistent with the definition of "associated person of a security-based swap dealer" contained in section 3(a)(70) of the Exchange Act, 15 U.S.C. 78c(a)(70), regardless of whether such non-U.S. person or such non-U.S. person's agent is itself a security-based swap dealer. See note 193, supra (discussing the Commission's proposed interpretation of the term "personnel" for purposes of proposed rule 3a71-3(b)(1)(iii)(C)).

243 Initially proposed Exchange Act rule 3a71-3(a)(6)(i)(A) provided that the U.S. business of a foreign security-based swap dealer included any transaction with a U.S. person, "other than with a foreign branch." The proposed amendment replaces this language with "other than a transaction conducted through a foreign branch of that person." Similarly, initially proposed Exchange Act rule 3a71-3(a)(6)(ii) provided that the U.S. business of a U.S. security-based swap dealer included any transaction of such dealer, other than transactions conducted through a foreign branch with a non-U.S. person "or another foreign branch." Proposed Exchange Act rule 3a71-3(a)(8)(ii) replaces this language with "or a transaction with a U.S. person counterparty that constitutes a transaction conducted through a foreign branch of the counterparty."

These changes are intended to clarify that the counterparty's activity in each such transaction must meet the definition of "transaction conducted through a foreign branch" set forth in Exchange Act rule 3a71-3(a)(3). These proposed changes are consistent with Exchange Act rule 3a71-3(b)(1)(iii)(A), which permits non-U.S. persons to exclude from the de minimis calculation transactions with U.S. persons, to the extent that such U.S. persons are engaging in transactions conducted through a foreign branch.

244 See proposed Exchange Act rule 3a71-3(a)(6).

245 See proposed Exchange Act rule 3a71-3(a)(7).

246 See proposed Exchange Act rule 3a71-3(a)(9).

conduct to, and increase transparency in, the security-based swap market and to require registered security-based swap dealers to treat parties to these transactions fairly. As noted above, the proposed rules would require, among other things, that registered security-based swap dealers communicate in a fair and balanced manner with potential counterparties and that they disclose conflicts of interest and material incentives to potential counterparties. Imposing these requirements on the U.S. business of registered security-based swap dealers should help protect the integrity of U.S. financial markets for all market participants.

We recognize that, depending on the particular structure used by a registered foreign security-based swap dealer to do business in the United States, its personnel (or personnel of its agent acting on its behalf) in the United States may be subject to other business conduct requirements under U.S. law (such as broker-dealer regulation) that govern the professional interactions of such personnel or agents with counterparties to a security-based swap.[247] We also recognize that these other requirements may afford security-based swap counterparties protections that may appear to be similar in many respects to the Title VII external business conduct standards. We preliminarily believe, however, that, notwithstanding any requirements that may apply to such intermediaries, it is appropriate to impose these Title VII requirements directly on registered foreign security-based swap dealers when they use personnel located in the

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[247] See note 198, supra (discussing the Exchange Act Exemptive Order). The Financial Industry Regulatory Authority ("FINRA") also adopted a rule, FINRA Rule 0180 (Application of Rules to Security-Based Swaps), which temporary limits the application of certain FINRA rules with respect to security-based swaps. On January 14, 2015, FINRA filed a proposed rule change, which was effective upon receipt by the Commission, extending the expiration date of FINRA Rule 0180 to February 11, 2016. See Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Extend the Expiration Date of FINRA Rule 0180 (Application of Rules to Security-Based Swaps), Exchange Act Release No. 74049 (Jan. 14, 2015).

United States to arrange, negotiate, or execute security-based swaps, even with counterparties that are also non-U.S. persons.

We note that, in Title VII, Congress has established a comprehensive framework of business conduct standards that applies to registered security-based swap dealers, and we preliminarily believe that this framework should govern their transactions with counterparties when such transactions raise transparency and market integrity concerns that are addressed by these requirements. Although other business conduct frameworks (such as broker-dealer regulation) may achieve similar regulatory goals, the availability of exceptions may mean that alternative frameworks may not apply to certain business structures used by registered security-based swap dealers to carry out their business in the United States.[248] In our preliminary view, it is appropriate to subject all registered security-based swap dealers engaged in U.S. business to the same external business conduct framework, rather than encouraging a patchwork of business conduct protections under U.S. law that may offer counterparties varying levels of protection with respect to their transactions with different registered security-based swap dealers depending on the business model (or models) that each registered security-based swap dealer has chosen to use in its U.S. business.[249]

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248 See note 202, supra (noting exception from broker-dealer definition for banks).

249 Consistent with the view we expressed in the Cross-Border Proposing Release, to the extent that a registered foreign security-based swap dealer uses personnel of an agent to arrange, negotiate, or execute security-based swap transactions from a U.S. branch or office, the dealer and its agent may choose to allocate between themselves specific responsibilities in connection with these external business conduct requirements. See Cross-Border Proposing Release, 78 FR 31026-27. However, we note that the registered foreign security-based swap dealer would remain responsible for ensuring that all relevant Title VII requirements applicable to a given security-based swap transaction are fulfilled. See id. at 31026. As noted above, the agent may also be required to register as a broker (or, potentially, as a security-based swap dealer), or as another regulated entity, depending on the nature of its security-based swap or other activity. See note 198 and accompanying text, supra; Cross-Border Proposing Release, 78 FR 31027 n.574. An agent may, accordingly, be subject to independent business conduct or other requirements with

We also note that imposing these external business conduct requirements on a registered foreign security-based swap dealer when it uses personnel located in a U.S. branch or office to arrange, negotiate, or execute security-based swaps with another non-U.S. person should mitigate competitive disparities between different categories of security-based swap dealers operating in the United States.[250] This concern is particularly acute given the ease with which U.S. security-based swap dealers may seek to avoid such competitive disparities by booking in non-U.S.-person affiliates any transactions arranged, negotiated, or executed by personnel located in the United States. As noted above, this restructuring would allow these dealers to continue using U.S. sales and trading personnel to carry on their security-based swap dealing business in a manner largely unchanged from what we understand to be current business practices while avoiding the external business conduct requirements of Title VII.[251]

We have considered the views of the commenters that opposed imposing external business conduct requirements on transactions between a registered foreign security-based swap dealer and a non-U.S.-person counterparty,[252] but we do not believe that the issues raised by commenters warrant refraining from imposing these requirements on all such transactions. The re-proposed approach, which focuses on a transaction of a registered foreign security-based swap dealer with another non-U.S. person only when the registered foreign security-based swap dealer is using personnel located in the United States to arrange, negotiate, or execute the security-based swap, should mitigate the concerns raised by one commenter regarding the potential effect

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respect to its interactions with the registered foreign security-based swap dealer's counterparties that occur in the course of its intermediation of such transactions.

250 See Section II.A, supra (discussing competitive effects of disparate regulatory treatment of activity in the United States).

251 See Section III.B.4, supra.

252 See, e.g., ICI Letter at 11.

of the initially proposed rule on U.S. fund managers that manage offshore funds, because, to the extent an offshore fund is not a U.S. person by virtue of having its principal place of business in the United States, only the location of personnel of the registered foreign security-based swap dealer or the location of personnel of its agent, and not that of persons acting on behalf of a non-U.S.-person fund in the transaction, would be relevant to whether the transaction is U.S. business or foreign business of the registered foreign security-based swap dealer.[253]

We also disagree with the commenter that suggested that such transactions have an insufficient nexus to the United States to warrant application of the external business conduct requirements and that the external business conduct requirement should apply only to transactions with U.S.-person counterparties.[254] As we discussed in the context of the de minimis exception above, a foreign security-based swap dealer arranging, negotiating, or executing a security-based swap transaction using personnel located in a U.S. branch or office is not solely "transacting a business in security-based swaps without the jurisdiction of the United States."[255] If the Commission adopts a rule that makes substituted compliance available for

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253 See notes 236-237, supra. To the extent that a non-U.S. regulated fund is a U.S. person (including because it has its principal place of business in the United States), a foreign security-based swap dealer would be required to comply with external business conduct requirements in any transaction with that fund because the counterparty is a U.S. person. See proposed Exchange Act rule 3a71-3(a)(8). Cf. Exchange Act rule 3a71-3(b)(1)(iii)(A) (requiring non-U.S. persons to include in their de minimis threshold calculations security-based swap transactions with U.S. persons in connection with their dealing activity); Cross-Border Adopting Release, 79 FR 47320 (describing Exchange Act rule 3a71-3(b)(1)(iii)(A)).

254 See notes 238-240, supra.

255 Exchange Act section 30(c). See also Section III.B.4(b), supra.

As noted above, we do not believe that our proposed approach applies Title VII to persons that 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. An approach that did not treat security-based swaps that a registered foreign security-based swap dealer has arranged, negotiated, or executed using its personnel or personnel of its agent located in the United States as the "U.S. business" of that dealer for purposes of proposed Exchange Act rule 3a71-3(c) would, in our view, reflect an understanding of what it means to conduct a security-based swaps external business conduct requirements and, pursuant to further Commission action, makes a substituted compliance determination, substituted compliance may be permitted in such transactions.[256]

Our re-proposed rule maintains our initially proposed approach to the foreign business of registered U.S. security-based swap dealers. We recognize that at least one commenter suggested that all transactions of a registered U.S. security-based swap dealer should be subject to the external business conduct requirements of Exchange Act section 15F,[257] but we continue to believe it is appropriate to provide this exception for the foreign business of such persons. As we noted in our initial proposal, the Dodd-Frank Act generally is concerned with the protection of U.S. markets and participants in those markets.[258] We continue to believe that subjecting U.S. security-based swap dealers to the Title VII customer protection requirements with respect to their security-based swap transactions conducted through their foreign branches outside the

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business within the jurisdiction of the United States that is divorced both from Title VII's statutory objectives and from the various structures that non-U.S. persons use to engage in security-based swap dealing activity. But in any event we also preliminarily believe that this proposed 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 prevent the relevant purposes of the Dodd-Frank Act from being undermined. See Cross-Border Adopting Release, 79 FR 47291-92 (interpreting anti-evasion provisions of Exchange Act section 30(c)). Without this rule, non-U.S. persons could simply carry on a dealing business within the United States with non-U.S. persons. Permitting this activity could allow these firms to retain full access to the benefits of operating in the United States while avoiding compliance with external business conduct requirements, which could increase the risk of misconduct. See Section III.B.4, supra.

256 As noted above, in the Cross-Border Proposing Release, we proposed an approach to substituted compliance with respect to the external business conduct requirements. See note 223, supra. We received comments on this proposed rule that we continue to consider, and we anticipate addressing those comments in the context of our consideration of final rules regarding the external business conduct requirement.

257 See note 235, supra.

258 See Cross-Border Proposing Release, 78 FR 31018.

United States with non-U.S. persons would not appreciably further the goal of protecting the U.S. market or U.S. market participants.

F. Request for comment

We request comment on all aspects of the re-proposed rule regarding application of the external business conduct requirements to registered security-based swap dealers, including the following:

- The re-proposed rule would apply the external business conduct standards to transactions that a registered foreign security-based swap dealer arranges, negotiates, or executes using personnel located in a U.S. branch or office, even if the counterparty is also a non-U.S. person. Are the external business conduct rules appropriately applied in this release? Should the external business conduct rules be expanded to cover other transactions discussed in this release? Should some or all of the external business conduct standards not apply to these activities? Why or why not? Please be specific in identifying why the concerns addressed by the external business conduct requirements do not arise in this context.
- The re-proposed rule would not apply the external business conduct standards to the foreign business of any registered security-based swap dealer. Should some or all of the external business conduct standards apply to the foreign business of these registered entities? Why or why not? Please be specific as to what policy objectives would be advanced by subjecting transactions resulting from the foreign business of a registered security-based swap dealer to the external business conduct requirement.

- The re-proposed rule would not apply the external business conduct standards to a transaction of a registered U.S. security-based swap dealer that is a transaction conducted through a foreign branch (assuming that the counterparty is a non-U.S. person or is a U.S. person for whom the transaction is also a transaction conducted through a foreign branch). Should some or all of the external business conduct standards apply to these transactions? Why or why not?
- What types of controls would be necessary to identify foreign business and U.S. business and ensure that the registered security-based swap dealer complies with the external business conduct standards with respect to its U.S. business? How would this work as an operational matter? Should U.S. business be generally defined with reference to the type of activity that, if performed in a dealing capacity, triggers the registration requirement?
- Should some or all of the external business conduct rules apply in transactions between a registered foreign security-based swap dealer and a foreign branch of a U.S. bank? Why or why not?
- Should some or all of the external business conduct rules apply in transactions between a registered non-U.S. security-based swap dealer and a non-U.S. person whose obligations under a security-based swap are guaranteed by a U.S. person that is conducted outside the United States? Why or why not?
- What would be the market impact of the re-proposed approach to application of the customer protection requirements? Would non-U.S. persons that engage in dealing activities seek to relocate to locations outside the United States personnel who currently arrange, negotiate, and execute transactions from locations within

the United States? Would the potential benefits of applying external business conduct requirements to transactions that are arranged, negotiated, or executed by a registered foreign security-based swap dealer in the United States reduce any incentives to relocate to locations outside the United States? What are the costs of such relocation? What factors would weigh against relocation in spite of those costs?

- How would the proposed application of the requirements affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? Why or why not? What other measures should we consider to implement the transaction-level requirements?

V. Application of Other Requirements to Cross-Border Security-Based Swap Activity

A. Overview

In light of our proposed amendment to Exchange Act rule 3a71-3(b), which would apply the de minimis exception to transactions of a non-U.S. person that are arranged, negotiated, or executed by personnel located in a U.S. branch or office in connection with the non-U.S. person's dealing activity, we have determined also to propose certain amendments to Regulation SBSR to address the applicability of the regulatory reporting and public dissemination requirements to such transactions.[259] However, we are not proposing to subject transactions between two non-U.S. persons that are arranged, negotiated, or executed in the United States to

[259] We also are soliciting comment on whether certain transactions of non-U.S. persons whose obligations under a security-based swap are guaranteed by a U.S. person should be exempt from the public dissemination requirement. See Section V.E.3, infra.

mandatory clearing or trade execution.

B. Previously Proposed and Adopted Rules Relating to Application of Clearing, Trade Execution, Regulatory Reporting, and Public Dissemination Requirements

1. Mandatory clearing and trade execution

In the Cross-Border Proposing Release, we proposed to impose both mandatory clearing and trade execution on "transactions conducted within the United States," subject to certain exceptions. Proposed rules 3Ca-3 and 3Ch-1 would have subjected such transactions to mandatory clearing (provided that we had issued a mandatory clearing determination with respect to the security-based swap) and mandatory trade execution (provided that the transaction had been made available to trade) if a person engaged in a security-based swap transaction that is a "transaction conducted within the United States," as defined in initially proposed Exchange Act rule 3a71-3(a)(5).[260] We also proposed an exception to this general requirement, under which a "transaction conducted within the United States" would not have been subject to the clearing or trade execution requirements if (i) neither counterparty to the transaction was a U.S. person; (ii) neither counterparty's performance under the security-based swap was guaranteed by a U.S. person; and (iii) neither counterparty to the transaction was a foreign security-based swap dealer. We proposed that the clearing and trade execution requirements would not apply to transactions that did not involve any of these three types of counterparties due to our preliminary view that, although such transactions conducted within the United States may give rise to operational risks

260 In addition, the proposed rules generally would have imposed these requirements on a security-based swap transaction if a counterparty to the transaction is a U.S. person or a non-U.S. person whose counterparty has a right of recourse against a U.S. person. See Cross-Border Proposing Release, 78 FR 31078, 31083. We also proposed an approach to substituted compliance with respect to each requirement. See id. at 31098, 31099-100. Although these provisions of the initial proposal are outside the scope of this release, we received comments on these provisions of the proposed rules, which we continue to consider and anticipate addressing in the context of our consideration of final rules regarding each requirement.

in the United States, the financial risk of such transactions would reside outside the United States.[261]

2. Regulatory reporting and public dissemination

In the Cross-Border Proposing Release, we re-proposed the entirety of Regulation SBSR, including rule 908(a) thereof, which, among other things, would have specified when a security-based swap was subject to the regulatory reporting and public dissemination requirements of Regulation SBSR.[262] Security-based swaps that fell within the proposed definition of "transaction conducted within the United States" would have been among the security-based swaps subjected both to regulatory reporting and to public dissemination under rule 908(a), as re-proposed in the Cross-Border Proposing Release.[263]

We recently adopted rule 908(a)(1), which requires regulatory reporting and public dissemination of security-based swap transactions that (i) have a direct or indirect counterparty[264]

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261 See Cross-Border Proposing Release, 78 FR 31080, 31084.

262 Rule 908(a), as initially proposed, would have required regulatory reporting of any security-based swap that is "executed in the United States or through any means of interstate commerce." See Regulation SBSR Proposing Release, 75 FR 75287. When we re-proposed rule 908(a)(1)(i) in the Cross-Border Proposing Release, we expressed concern that the language in the Regulation SBSR Proposing Release could have unduly required a security-based swap to be reported if it had only the slightest connection with the United States. See Cross-Border Proposing Release, 78 FR 31061.

263 Rule 900(ii), as re-proposed in the Cross-Border Proposing Release, would have defined "transaction conducted within the United States" to have the meaning as given in the definition of the term under previously proposed Exchange Act rule 3a71-3(a)(5)(i).

264 Rule 900(hh) of Regulation SBSR defines "side" to mean "a direct counterparty and any guarantor of that direct counterparty's performance who meets the definition of indirect counterparty in connection with the security-based swap." Rule 900(p) of Regulation SBSR defines "indirect counterparty" to mean "a guarantor of a direct counterparty's performance of any obligation under a security-based swap such that the direct counterparty on the other side can exercise a right of recourse against the indirect counterparty in connection with the security-based swap; for these purposes a direct counterparty has a right of recourse against a guarantor on the other side if the direct counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the guarantor in connection

that is a U.S. person on either or both sides of the transaction, or (ii) are accepted for clearing by a clearing agency having its principal place of business in the United States. In addition, rule 908(a)(2), as adopted, requires regulatory reporting but not public dissemination of transactions that have a direct or indirect counterparty that is a registered security-based swap dealer or registered major security-based swap participant on either or both sides of the transaction but do not otherwise fall within rule 908(a)(1).[265] We did not, however, include in that final rule a provision addressing a security-based swap transaction that is a "transaction conducted within the United States," noting that commenters had expressed divergent views on this particular element of the re-proposed rule. We also noted that we anticipated seeking additional public comment on whether and, if so, how regulatory reporting and public dissemination requirements should be applied to transactions involving non-U.S. persons when they carry out relevant activities in the United States.[266]

We also previously proposed rule 908(b), which would have provided that, notwithstanding any other provision of Regulation SBSR, a person would not incur any obligation under Regulation SBSR unless the person is:

(1) a U.S. person;

(2) a security-based swap dealer or major security-based swap participant; or

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with the security-based swap." A "direct counterparty" is a person that is a primary obligor on a security-based swap. See Exchange Act rule 900(k) (defining "direct counterparty").

265 See rule 908(a). We also simultaneously proposed certain amendments to Regulation SBSR. See Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information; Proposed Rule ("Regulation SBSR Proposed Amendments Release"), Exchange Act Release No. 74245 (February 11, 2015), 80 FR 14739 (March 19, 2015). These proposed amendments generally address issues separate from those being addressed in this release.

266 See Regulation SBSR Adopting Release, 80 FR 14655.

(3) a counterparty to a transaction conducted within the United States.[267]

Our recently adopted rule 908(b) included only the first two of these prongs, and the Regulation SBSR Adopting Release clarified that a security-based swap dealer or major security-based swap participant that is not a U.S. person would incur an obligation under Regulation SBSR only if it is registered.[268] We noted that we anticipated soliciting additional public comment on whether regulatory reporting and/or public dissemination requirements should be extended to transactions occurring within the United States between non-U.S. persons and, if so, which non-U.S. persons should incur reporting duties under Regulation SBSR.[269]

Finally, in the Cross-Border Proposing Release, we re-proposed rule 901(a), which set forth a reporting hierarchy for identifying which side has a duty to report in a variety of transactions. This rule would have provided, among other things, that, in a transaction in which neither side included a security-based swap dealer or major security-based swap participant, if one side included a U.S. person while the other side did not, the side with the U.S. person would have been the reporting side; if both sides in such transaction included a U.S. person or neither side included a U.S. person, the sides would have been required to select the reporting side.[270] In the Regulation SBSR Adopting Release, we adopted rules establishing the reporting hierarchy for a range of transactions, including a provision that, in a transaction in which neither side includes a registered security-based swap dealer or registered major security-based swap participant but both sides include a U.S. person, the sides shall select the reporting side.[271] We

267 See Cross-Border Proposing Release, 78 FR 31065.

268 See rule 908(b); Regulation SBSR Adopting Release, 80 FR 14656.

269 See Regulation SBSR Adopting Release, 80 FR 14655.

270 See Regulation SBSR Adopting Release, 80 FR 14597.

271 See rule 901(a)(2)(ii)(E)(1).

noted in that release that we anticipated soliciting additional comment about how to apply Regulation SBSR, including which side should incur the reporting duty, in transactions between two unregistered non-U.S. persons and transactions between an unregistered U.S. person and an unregistered non-U.S. person.[272]

C. Commenters' Views

1. General comments on application of clearing, trade execution, regulatory reporting, and public dissemination requirements

One commenter generally supported our proposed territorial approach to applying these requirements, noting that the requirements "would encompass any transaction with a U.S. person or within the U.S."[273] Similarly, another market participant agreed with our proposed application of these requirements to security-based swaps entered into by offshore funds that have a U.S. nexus, arguing that a failure to apply such requirements would undermine central objectives of the Dodd-Frank Act, create opportunities for regulatory arbitrage, and risk fragmenting the security-based swap market.[274]

At the same time, other commenters raised concerns about our proposed approach.[275] Some commenters explained that applying mandatory clearing, mandatory trading, regulatory reporting, and public dissemination requirements to transactions between non-U.S. branches of

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272 See Regulation SBSR Adopting Release, 80 FR 14598.

273 Better Markets Letter at 19-20.

274 See Citadel Letter at 1.

275 See, e.g., IIB Letter at 6-7, 23 (stating that the registration requirement, external business conduct standards, clearing, trade execution, regulatory reporting, and public dissemination requirements should not apply to transactions of non-U.S. persons with foreign security-based swap dealers based on conduct in the United States when neither counterparty's obligations under the security-based swap are guaranteed by a U.S. person, because such an application would create "serious operational, legal and economic difficulties for foreign security-based swap market participants").

two U.S. persons would lead to duplication of, and conflicts with, foreign requirements.[276] Another commenter criticized the proposed approach to categorization of these requirements, stating that the proposal did not classify regulatory reporting, public dissemination, mandatory clearing, or mandatory trade execution as either entity-level requirements or transaction-level requirements but as a distinct category of "transactional requirements" that apply to persons regardless of their registration status.[277] This commenter argued that multiple categories of requirements make it more difficult for market participants to determine which requirements apply and whether substituted compliance is available.[278] The commenter contended that it would be simpler and more rational to apply the clearing, trade execution, regulatory reporting, and public dissemination requirements in the same way that we proposed to apply the external business conduct requirements.[279]

2. Comments on mandatory clearing and mandatory trade execution

Market participants expressed a range of views regarding the application of mandatory clearing and mandatory trade execution to transactions of non-U.S. persons conducted within the United States. One commenter supported our proposed definition of "transaction conducted within the United States" together with our proposal to impose the clearing requirement on such transactions because this approach would help ensure that the security-based swap activity of offshore funds managed by U.S.-based investment managers is subject to our clearing requirements.[280] Two commenters specifically argued that the proposed exceptions from the

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276 See IIB Letter at 9; EC Letter at 2.

277 See SIFMA/FIA/FSR Letter at A-38 to A-39.

278 See id.

279 See id.

280 See Citadel Letter at 3.

application of mandatory clearing should be eliminated,[281] and one commenter urged the same with respect to mandatory trade execution.[282] One of these commenters suggested that, at most, we should permit substituted compliance for the transactions rather than excepting them from any application of the clearing requirement.[283]

Other commenters opposed an activity-based application of mandatory clearing or trade execution. One market participant argued that conduct in the United States should not trigger the application of the clearing requirement because the test "is impractical, cannot be justified by cost-benefit analysis and exceeds the Commission's SBS authority under the Exchange Act."[284] Another commenter opposed applying regulatory requirements, including clearing and trade execution, to transactions between two unguaranteed non-U.S. persons that involve activity in the United States, regardless of their status as registered security-based swap dealers.[285]

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281 See AFR Letter at 10 (arguing that the exceptions were unreasonable because "no provision of Dodd-Frank justifies exempting security-based swaps that occur within our borders from U.S. regulatory requirements"); Better Markets Letter at 22 (arguing that the exception for the clearing requirement conflicts with the Commission's territorial approach). Cf. Letter from AFR to CFTC and SEC, dated November 25, 2014 (arguing that foreign subsidiaries of U.S. firms without guarantees may present risk to the United States).

282 See Better Markets Letter at 22.

283 See AFR Letter at 10.

284 See SIFMA/FIA/FSR Letter A-48. See also FOA Letter at 8 (stating that a transaction conducted within the United States that involves one non-U.S. person security-based swap dealer is insufficiently connected to the United States to require mandatory clearing and mandatory trade execution).

285 See ICI Letter at 8-10 n.23 (explaining that the risk in such transactions is outside the United States, that the counterparties would have no expectation that the requirements would apply, and that U.S. persons and non-U.S. persons that use U.S. asset managers would be placed at a competitive disadvantage); EC Letter at 2 (submitting that the Commission's rules should not apply to a transaction where the legal counterparty is a non-U.S. person, on the basis that there is no counterparty risk to a U.S. person in such a transaction).

3. Comments on regulatory reporting and public dissemination

Commenters expressed divergent views regarding application of Regulation SBSR to transactions involving the conduct of non-U.S. persons within the United States.[286] Noting its general opposition to the proposed "transaction conducted within the United States" concept, one commenter argued that the regulatory reporting and public dissemination requirements should not apply to transactions conducted within the United States between two non-U.S.-person counterparties because the proposed requirement would likely result in "duplicative reporting requirements."[287] Another commenter argued that it would be "unnecessary and unworkable" to require transactions that are between non-U.S. persons and are executed but not cleared in the United States to be reported, noting that such transactions would generally be subject to reporting in the counterparties' jurisdictions and additional reporting to a U.S. SDR would impose additional significant costs.[288] Another commenter argued that applying Regulation SBSR on the basis of conduct in the United States would not be workable because it would require a trade-by-trade analysis rather than "party level static data," for which system

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286 See Citadel Letter at 1-2; ABA Letter at 3 (noting that the initially proposed activity-based approach is consistent with longstanding Commission practice but also noting potential ambiguities); IAA Letter at 6 (explaining that the proposed term may capture parties with minimal connection to the United States); IIB Letter at 8-9 (explaining that application of the term may result in duplicative and conflicting regulation); EC Letter at 2 (explaining that the Commission's rules should not apply because no U.S. firms are subject to counterparty credit risk in such transactions); FOA Letter at 7-8 (explaining that the test would reach transactions with minimal nexus to the United States); JFMC Letter at 4-5 (requesting that the Commission not apply its rules to such transactions based on its belief that such an approach would conflict with the CFTC approach).

287 SIFMA/FIA/FSR Letter at A-42.

288 Letter from Cleary Gottlieb Steen & Hamilton LLP to CFTC, SEC, Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, and Farm Credit Administration ("Cleary Letter"), dated September 20, 2011 at 28 (suggesting that the Commission adopt accommodations for the use of non-U.S. SDRs in appropriate cases).

architecture does not currently exist.[289] This commenter also stated that market participants do not have the capability to determine whether their counterparty's activities trigger the proposed conduct test.[290]

4. The CFTC Staff Advisory and responses to the CFTC Request for Comment

As noted above, in response to the solicitation of comment on the CFTC Staff Advisory, commenters raised concerns specifically with respect to the application of the approach in that document to the CFTC's transaction-level requirements.

Some commenters suggested that only those CFTC transaction-level requirements directly relevant to the specific activities that the swap dealer carries out from a U.S. location should apply to the transaction, generally taking the view that the CFTC's regulatory interest extends only to counterparty-facing activities and not, for example, to the risk-mitigation aspects of Title VII.[291] One commenter suggested, however, that certain counterparty-facing

289 See Letter from ISDA to SEC dated November 14, 2014 ("ISDA Letter") at 18 (urging us not to apply Regulation SBSR on the basis of conduct within the United States as it would not be practicable). This commenter also argued that counterparties to a transaction executed on an SB SEF, and not the SB SEF itself, should be required to report such transactions. See id. at 7. See also Regulation SBSR Proposed Amendments Release, 80 FR 14748-49 (citing additional comment letters addressing this issue).

290 See ISDA Letter at 18. This commenter also argued that, because in its view a security-based swap involving only non-U.S. persons that are not registered as a security-based swap dealer or as a major security-based swap participant should not be required to be reported, the reporting hierarchy need not address the reporting obligations arising from such security-based swap transactions. See id. at 19.

291 See IIB Letter to CFTC at 8-10 (arguing that, if the CFTC adopts the CFTC Staff Advisory, it should apply only the transaction-level requirements relevant to the activity that occurs within the United States); SIFMA/FIA/FSR Letter to CFTC at A-9 to A-11 (any approach adopted by the CFTC that is based on the use of personnel located in the United States should trigger only requirements that relate to concerns raised by the conduct that triggered the requirements); Barclays Letter to CFTC at 3 (arguing that the only transaction-level requirements whose objectives are implicated by activity in which the "sole nexus to the U.S. is the participation of U.S.-based personnel of a non-U.S. swap dealer" are requirements related to "sales practices" and that, therefore, the only relevant transaction-level requirements that should apply to such transactions, should the CFTC adopt an approach that is based on the use of personnel located in the United States, are pre-trade disclosure requirements); ISDA Letter to CFTC at 9 (suggesting

communications raise no concerns relevant to Title VII and therefore should not trigger application of transaction-level requirements, even if a swap dealer engages in such communications within the United States.[292] Another commenter noted that this approach would help ensure that costs and benefits of such an approach were commensurate.[293]

Commenters also noted that a non-U.S.-person swap dealer using personnel or agents located in the United States to arrange, negotiate, or execute swap transactions generally would already be subject to regulation in its home jurisdiction.[294] In their view, adoption of the CFTC Staff Advisory would raise the possibility of conflicting and duplicative regulation of such non-U.S.-person swap dealers and reflected a lack of comity on the CFTC's part toward regulators in other jurisdictions.[295]

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that, should the CFTC adopt the approach in the CFTC Staff Advisory, only those transaction-level requirements that are transaction-specific and that relate to the triggering communication—transaction specific disclosure and communications—should apply to the transaction).

292 See SIFMA/FIA/FSR Letter at A-11 to A-12 (stating that "arranging and negotiating trading relationships and legal documentation and providing legal advice as well as providing credit terms and technical terms, market color, market research or a general discussion of the swap transaction" have no relation to any concerns of the Dodd-Frank Act in transactions between two non-U.S. persons).

293 See Barclays Letter to CFTC at 3.

294 See CDEU Letter to CFTC at 2, 3 (arguing that the approach in the CFTC Staff Advisory represents a departure from the CFTC Cross-Border Guidance in that a transaction between two entities organized under German law would be subject to the Title VII requirements and the EMIR requirements, which would be duplicative and unnecessary, without any ability for substituted compliance); IIB Letter to CFTC at 5 (explaining that "[i]t would stand international comity on its head for the [CFTC]" to adopt the CFTC Staff Advisory's approach of imposing regulatory requirements on non-U.S. firms on the basis of "limited activities" of their U.S. personnel or agents when the foreign jurisdiction has strong supervisory interests in the risks arising from the transactions); JFMC Letter to CFTC at 1 (explaining that the CFTC Staff Advisory's approach to applying transaction-level requirements does not account for the application of foreign regimes to the transaction).

295 See SIFMA/FIA/FSR Letter to CFTC at A-6 (explaining that the CFTC Staff Advisory fails to respect comity principles because it would not "give due recognition to the compelling supervisory interests of home regulators in the jurisdictions in which these transactions occur"). See also IIB Letter to CFTC at 6 (arguing that Dodd-Frank incorporates mechanism for addressing competition concerns: a "mandate" for international harmonization). Accordingly,

Some commenters suggested that adoption of the CFTC Staff Advisory could present difficulties for, and impose costs on, non-U.S.-person counterparties of dealers, as such counterparties may not currently have systems in place for complying with certain CFTC requirements, particularly if they are imposed only because the swap dealer (and not the counterparty) happens to have carried out certain activities using personnel or agents located in the United States.[296] As a result, commenters argued that non-U.S. swap dealers may no longer be able to service non-U.S.-person counterparties from U.S. locations.[297] Some commenters noted possible competitive effects of imposing, or not imposing, transaction-level requirements on such transactions. One commenter supported the CFTC Staff Advisory, arguing that without it, U.S. firms would be at a competitive disadvantage compared to non-U.S. firms operating in the United States, because U.S. firms would be subject to different rules for the same transactions.[298]

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they urged the CFTC to make substituted compliance available in such transactions. See CDEU Letter to CFTC at 5 (urging the CFTC to make substituted compliance determinations with respect to the transaction-level requirements and to defer to foreign regulators to regulate entities that are organized under the laws of their jurisdiction); ISDA Letter to CFTC at 4 (arguing that substituted compliance should be available for transactions between a non-U.S. swap dealer and a non-U.S. counterparty if the CFTC adopts the approach in the CFTC Staff Advisory); SIFMA/FIA/FSR Letter to CFTC at A-13 (suggesting that substituted compliance be available for the transaction-level requirements).

296 See, e.g., SIFMA/FIA/FSR Letter to CFTC at A-4 (explaining that certain non-U.S.-person counterparties may not have clearing relationships with FCMs, and requiring them to clear through an FCM simply because the dealer happens to use personnel within the United States in the transaction would be costly).

297 See, e.g., ISDA Letter to CFTC at 4.

298 See AFR Letter to CFTC at 3 (explaining that "any weakening of [the] advisory would open the door to regular and significant levels of swaps activities being performed within the U.S. by nominally foreign entities under foreign rules, or in some cases no rules at all," whereas U.S. firms operating in the United States would be subject to different rules for the same transactions operating in the same market).

Some commenters indicated that adoption of the CFTC Staff Advisory would also disadvantage non-dealing counterparties. For example, one commenter argued that, were the CFTC Staff Advisory adopted, end users that trade with non-U.S. swap dealers might face competitive disadvantages.[299] Other commenters noted that the application of transaction-level requirements to such transactions could put foreign swap dealers at a competitive disadvantage because it would be overly burdensome for them to use U.S.-based personnel or agents to perform certain function in connection with their dealing activity, particularly with respect to transactions with foreign counterparties that may oppose being subject to transaction-level requirements, and that the adoption of the CFTC Staff Advisory would therefore encourage dealers not to use their U.S.-based personnel.[300]

D. Mandatory Clearing and Trade Execution

After careful consideration of concerns raised by commenters and our further consideration of policy concerns relevant to the security-based swap market, we are not proposing to subject transactions between two non-U.S. persons to the clearing requirement (and,

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299 See CDEU Letter to CFTC at 2 (urging the CFTC not to adopt the Staff Advisory because it would lead to competitive disadvantages for certain non-U.S. end-user affiliates that had relied on trading with non-U.S. swap dealers compared to other non-U.S. end users in the same markets that currently hedge with unregistered counterparties). This commenter also expressed concern that applying the transaction-level requirements to such transactions would disadvantage non-U.S.-person non-dealers that choose to hedge with non-U.S. swap dealers using personnel or agents in the United States, as compared to non-U.S. persons that choose to hedge with unregistered counterparties or dealers that do not use personnel or agents in the United States. See CDEU Letter to CFTC at 1-2.

300 See ISDA Letter to CFTC at 4 (noting that non-U.S. counterparties have insisted that a swap dealer not use its U.S.-based personnel so as to avoid being subject to transaction-level requirements). See also JFMC Letter to CFTC at 1 (explaining that adoption of the CFTC Staff Advisory would create regulatory uncertainty and disrupt the planning of firms' systems and put Asia-based swap dealers at a disadvantage if they want to use U.S.-based personnel or agents).

by extension, to the trade execution requirement[301]) on the basis of dealing activity in the United States, including transactions that are arranged, negotiated, or executed by personnel located in a U.S. branch or office.

As we noted in the Cross-Border Proposing Release, because the financial risks of such a transaction reside outside the United States, "it is not necessary to apply the mandatory clearing requirement to a transaction between two non-U.S. persons solely" because the transaction involves activity in the United States.[302] However, the proposed approach would have subjected a "transaction conducted within the United States" involving at least one registered foreign security-based swap dealer to the clearing requirement (and, as noted, to the trade execution requirement). We proposed this approach because we preliminarily believed that registered foreign security-based swap dealers would have a more significant connection to the United States and to minimize potential competitive disparities between U.S. persons and non-U.S. persons.[303]

On further consideration, however, we now preliminarily believe that we should not impose the clearing requirement on a security-based swap transaction between two non-U.S. persons where neither counterparty's obligations under the security-based swap are guaranteed by a U.S. person, even if the transaction involves one or more registered foreign security-based swap dealers. In our view, a key objective of the clearing requirement is to mitigate systemic

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301 We continue to believe that, under the statutory framework, a security-based swap transaction is potentially subject to the trade execution requirement only if it is first subject to the clearing requirement. See Cross-Border Proposing Release, 78 FR 31082. Accordingly, to the extent that the clearing requirement does not apply to a particular security-based swap transaction, the trade execution requirement also would not apply. See id. (noting that, to the extent that we are proposing not to apply the clearing requirement to a particular transaction, the trade execution requirement would not apply to such transaction).

302 Cross-Border Proposing Release, 78 FR 31080.

303 See id. at 31080.

and operational risk in the United States, but the counterparty credit risk and operational risk of such transactions reside primarily outside the United States.[304] Accordingly, we preliminarily believe that subjecting such security-based swaps to the clearing requirement would not significantly advance what we view as a key policy objective of the clearing requirement applicable to security-based swaps under the Dodd-Frank Act.[305]

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[304] See id. at 31077; note 285, supra (citing EC Letter arguing that activity between two non-U.S. persons in the United States does not create counterparty credit risk in the United States). We recognize that even if a transaction involving one or more registered foreign security-based swap dealers that is arranged, negotiated, or executed by personnel located in the United States does not create financial or counterparty credit risk that resides in the United States, it may create operational risks associated, for example, with the processing of the transaction. See id. However, such risks are borne primarily by the counterparties to the transaction, both of whom are by definition—in the transactions being addressed in this release—non-U.S. persons (because they are incorporated outside the United States and do not have their principal place of business in the United States). Accordingly, any reduction of operational risks in the U.S. financial market that would be produced by requiring these transactions to be cleared by a U.S.-registered clearing agency would likely be insignificant. On the other hand, imposing the clearing requirement on a transaction between two non-U.S. persons involving at least one registered foreign security-based swap dealer because the transaction was arranged, negotiated, or executed in the United States to be cleared by a U.S.-registered clearing agency would directly expose that clearing agency and, through it, the U.S. financial system to the counterparty credit risk of the transaction.

[305] For these reasons, we disagree with commenters that characterized any exception from the clearing requirement as "indefensible" or "unreasonable." See note 281, supra.

We recognize that another commenter suggested that our initially proposed approach, which would have required a "transaction conducted within the United States" to be cleared, subject to certain exceptions, would help ensure that transactions of non-U.S.-person funds that are managed by U.S.-based investment managers are subject to the Title VII clearing requirement. See note 280, supra (citing Citadel Letter). Under the approach set forth in this release, the transactions of such funds may not be subject to the clearing requirement when the counterparty is not a U.S. person, but, as already noted, the risks of such transactions reside primarily outside the United States, and we preliminarily do not believe that requiring such transactions to be cleared would further the purposes of the clearing requirement. To the extent that the fund has its principal place of business in the United States, of course, it would be a U.S. person and, under the approach set forth in our Cross-Border Proposing Release, would be subject to the clearing requirement. See Exchange Act rule 3a71-3(a)(4)(B) (defining "U.S. person" to include, among other things, an investment vehicle "having its principal place of business in the United States"); Cross-Border Proposing Release, 78 FR 31078 (describing applicability of clearing requirement to U.S. persons under that proposal). Cf. note 285, supra (citing ICI Letter noting that mere presence of an investment manager in the United States does not necessarily create risk in the United States).

We recognize that, to the extent that a non-U.S. person using personnel located in a U.S. branch or office to arrange, negotiate, or execute security-based swap transactions in connection with its dealing activity is affiliated with a U.S. financial firm, the non-U.S. person's security-based swap exposures may pose risk to its U.S. affiliates in the United States, as U.S. entities that are affiliated with non-U.S. persons may determine for reputational reasons that they must support their non-U.S. affiliates at times of crisis.[306] However, as we noted in the Cross-Border Adopting Release, 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,[307] and we preliminarily believe the same principle applies here. Moreover, we note that it is likely that such a non-U.S. person engaged in significant security-based swap dealing activity would be a registered security-based swap dealer under our proposed approach and subject to Title VII capital and margin requirements, which we preliminarily believe would be a more narrowly tailored and appropriate way of mitigating any such risk in this context.[308] Under proposed rule 3a71-3(b)(1)(iii)(C), the non-U.S. person would be required to include in its dealer de minimis threshold calculations any security-based swap transaction that it arranged, negotiated, or executed in connection with its dealing activity using personnel located in a U.S.

306 See Cross-Border Adopting Release, 79 FR 47318. As we noted in the Cross-Border Adopting Release, however, 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. See Cross-Border Adopting Release, 79 FR 47318 n.348.

307 See id. at 47318-19.

308 We also note in this regard the relatively low liquidity of the security-based swap market in general, even for the most liquid products. See Section II.B.3, supra.

branch or office. Any non-U.S. person engaged in significant activity in the United States, including a non-U.S.-person affiliate of a U.S. financial firm whose obligations under a security-based swap are not guaranteed by its U.S. parent, would be required to register as a security-based swap dealer and comply with Title VII capital and margin requirements (along with other entity-level requirements). Whereas the clearing requirement would have applied only to certain transactions of registered foreign security-based swap dealers, capital and margin requirements would apply to all of their security-based swap transactions, including those that do not involve personnel located in a U.S. branch or office.[309]

We also preliminarily believe that requiring such security-based swap transactions to be cleared (and executed on a platform) would impose a significant burden on certain market participants. Some non-U.S. person counterparties may not currently have a direct or indirect relationship with a U.S.-registered clearing agency, and the burdens of establishing such a relationship may deter these non-U.S. persons—particularly those not engaged in dealing activity—from entering into security-based swap transactions with non-U.S. persons that, in connection with their dealing activity arrange, negotiate, or execute such transactions using personnel located in a U.S. branch or office.[310] Given that, under our proposed approach, a non-U.S. person that engages in significant security-based swap activity using personnel located in a U.S. branch or office is likely to be required to register and be subject to Title VII capital and

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309 See, e.g., Cross-Border Proposing Release, 78 FR 31011-12 (proposing to treat margin as an entity-level requirement).

310 See notes 296-297, supra. Establishing a direct relationship with a clearing agency may entail upfront costs that include, among other things, meeting minimum capital requirements and making minimum clearing fund contributions. See, e.g., ICE Clear Credit Clearing Rules at 12 and 90 (available at: https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Rules.pdf, last visited April 15, 2015).

margin requirements with respect to all of its transactions, we preliminarily do not believe that subjecting a subset of these persons' activities to the clearing requirement is likely to provide a significant additional reduction in counterparty credit risk in the United States. Consistent with customary Commission practice, we expect that Commission staff will monitor developments in the security-based swap market, including changes in liquidity or market fragmentation, that may warrant reconsideration of this proposed approach and, if necessary and appropriate, make recommendations to address such developments.

Because such security-based swap transactions would not be subject to the clearing requirement, under our proposed approach they would also not be subject to mandatory trade execution. While we acknowledge that trading between two non-U.S. persons in the OTC market may indirectly affect liquidity available to market participants subject to mandatory trade execution,[311] we preliminarily do not believe that it is appropriate to require such non-U.S. persons to shift their non-U.S. business to trading platforms merely because one of the counterparties to the transaction uses personnel located in a U.S. branch or office to arrange, negotiate, or execute the transaction.[312] As with the clearing requirement, and consistent with customary Commission practice, we expect that Commission staff will monitor developments in the security-based swap market, including changes in liquidity or market fragmentation, that may warrant reconsideration of this proposed approach and, if necessary and appropriate, make recommendations to address such developments.

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311 See Section VI.C.4, infra.

312 See note 308, supra.

E. Regulation SBSR

We are proposing amendments to Regulation SBSR to address the application of the regulatory reporting and public dissemination requirements to certain transactions not addressed in the Regulation SBSR Adopting Release or the Regulation SBSR Proposed Amendments Release.

1. Statutory framework

Section 13A(a)(1) of the Exchange Act[313] provides that "[e]ach security-based swap that is not accepted for clearing by any clearing agency or derivatives clearing organization shall be reported to—(A) a registered security-based swap data repository described in section 13(n); or (B) in the case in which there is no security-based swap data repository that would accept the security-based swap, to the Commission." Section 13(m)(1)(G) of the Exchange Act[314] provides that "[e]ach security-based swap (whether cleared or uncleared) shall be reported to a registered security-based swap data repository."

Section 13(m)(1)(B) of the Exchange Act[315] directs the Commission "to make security-based swap transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery." Section 13(m)(1)(C) of the Exchange Act[316] authorizes the Commission to provide by rule for the public availability of security-based swap transaction, volume, and pricing data. Furthermore, section 13(m)(1)(D) of the Exchange Act[317] authorizes the Commission to require registered entities (such as registered

[313] 15 U.S.C. 78m-1(a)(1).

[314] 15 U.S.C. 78m(m)(1)(G). See also 15 U.S.C. 78q(a)(1).

[315] 15 U.S.C. 78m(m)(1)(B). See also 15 U.S.C. 78q(a)(1).

[316] 15 U.S.C. 78m(m)(1)(C).

[317] 15 U.S.C. 78m(m)(1)(D).

SDRs) to publicly disseminate the security-based swap transaction and pricing data required to be reported under section 13(m) of the Exchange Act. Finally, section 13(n)(5)(D)(ii) of the Exchange Act[318] requires SDRs to provide security-based swap information "in such form and at such frequency as the Commission may require to comply with the public reporting requirements."

In the Regulation SBSR Adopting Release, we interpreted the regulatory reporting and public dissemination requirements to apply to security-based swaps that "exist, at least in part, within the United States"[319] and noted that a security-based swap with a direct or indirect counterparty that is a U.S. person necessarily would exist within the United States.[320] This view is consistent with a territorial approach to the statutory language requiring the reporting of "[e]ach security-based swap," and with the statutory requirement that security-based swaps that are reported must be publicly disseminated, unless an exception applies.[321] In our view, it is also consistent with a territorial approach to these statutory provisions to require each security-based swap that is otherwise subject to regulatory requirements under Title VII (as implemented under our territorial approach to implementing those requirements) to be reported and publicly disseminated pursuant to Regulation SBSR.

2. Proposed amendments regarding application of Regulation SBSR to certain security-based swap transactions

[318] 15 U.S.C. 78m(n)(5)(D)(ii).

[319] See, e.g., Regulation SBSR Adopting Release, 80 FR 14651.

[320] See Regulation SBSR Adopting Release, 80 FR 14650.

[321] See Regulation SBSR Adopting Release, 80 FR 14649-50.

(a) Security-based swap transactions that a non-U.S. person, in connection with its dealing activity, arranges, negotiates, or executes using personnel located in a U.S. branch or office

We propose to amend rule 908(a)(1) of Regulation SBSR to include a provision that would require any security-based swap transaction connected with a person's security-based swap dealing activity that is arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office—or by personnel of its agent located in a U.S. branch or office—to be reported to a registered SDR and publicly disseminated pursuant to Regulation SBSR.[322] This proposed amendment generally reflects the approach described in our Cross-Border Proposing Release, which would have subjected "transactions conducted within the United States" to both regulatory reporting and public dissemination requirements.[323] Consistent

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322 See proposed rule 908(a)(1)(v). We intend the proposed rule to indicate the same type of activity by personnel located in the United States as described in Section III.B.5, supra. Moreover, for purposes of proposed rule 908(a)(1)(v), we would interpret the term "personnel" in a manner consistent with the definition of "associated person of a security-based swap dealer" contained in section 3(a)(70) of the Exchange Act, 15 U.S.C. 78c(a)(70), regardless of whether such non-U.S. person or such non-U.S. person's agent is itself a security-based swap dealer. See note 193, supra (discussing the Commission's proposed interpretation of the term "personnel" for purposes of proposed rule 3a71-3(b)(1)(iii)(C)).

323 We preliminarily believe that the approach reflected in this release, which focuses only on whether a counterparty in connection with its dealing activity has arranged, negotiated, or executed the security-based swap transaction using personnel located in the United States, should mitigate many of the concerns raised by commenters. See note 286, supra (citing several comment letters arguing, among other things, that requirements, including Regulation SBSR, should not apply to transactions with only a minimal connection to the United States). See also notes 289-290, supra (citing comment letters arguing that looking to activity in the United States as a trigger for Regulation SBSR would not be practicable); note 292, supra (citing SIFMA/FIA/FSR Letter).

We recognize that some commenters suggested that certain Title VII requirements, including the regulatory reporting and public dissemination requirements implemented by Regulation SBSR, should not apply to transactions between two non-U.S. persons even if they involve activity in the United States because of operational complications or potential regulatory overlap or duplication. See note 275-276, 286-287, and 294-295, supra. We do not believe, however, that reporting a security-based swap to a registered SDR is likely to pose significant challenges, as the burden is borne under our rules only by one side of the transaction, and at least one counterparty to any transaction arranged, negotiated, or executed by a non-U.S. person, in connection with its dealing with that approach, it would expand the scope of Regulation SBSR in two ways. First, it would require the security-based swaps that a registered foreign security-based swap dealer arranges, negotiates, or executes using personnel located in a U.S. branch or office to be publicly disseminated, even if the counterparty to such transaction is another non-U.S. person whose obligations under the security-based swap are not guaranteed by a U.S. person.[324] Second, it would require that a transaction of a non-U.S. person that is not a registered security-based swap dealer be subject to both regulatory reporting and public dissemination under Regulation SBSR if that non-U.S. person would be required to include the transaction in its de minimis threshold calculations under proposed Exchange Act rule 3a71-3(b)(1)(iii)(C), as described above.

Requiring these transactions to be reported to a registered SDR should enhance our ability to oversee relevant activity related to security-based swap dealing occurring within the United States as well as to monitor market participants for compliance with specific Title VII requirements (including the requirement that a person register with the Commission as a security-based swap dealer if it exceeds the de minimis threshold). We preliminarily believe it would also likely enhance our ability to monitor for manipulative and abusive practices involving security-based swap transactions or transactions in related underlying assets, such as

activity, using personnel located in a U.S. branch or office is already likely to have infrastructure in place to report transactions to a registered SDR.

324 Under Exchange Act rule 3a71-1(c), absent a limitation by the Commission, a security-based swap dealer is deemed to be a security-based swap dealer with respect to each security-based swap it enters into, regardless of the type, class, or category of the security-based swap or the person's activities in connection with the security-based swap. Accordingly, for purposes of this proposed amendment, any transaction that a registered security-based swap dealer arranged, negotiated, or executed using personnel located in a U.S. branch or office would be "in connection with its dealing activity" and subject to both regulatory reporting and public dissemination.

corporate bonds or other securities transactions that result from dealing activity, or other relevant activity, in the U.S. market.

Subjecting these transactions to the public dissemination requirements of Regulation SBSR should enhance the level of transparency in the U.S. security-based swap market, potentially reducing implicit transaction costs[325] and promoting greater price efficiency. As we noted in the Regulation SBSR Adopting Release, the current market for security-based swaps is opaque.[326] Dealers can observe order flow submitted to them by customers and other potential counterparties and know about their own executions, and may know about other dealers' transactions in certain instances, but information about executed transactions is not widespread. Market participants—particularly non-dealers—have to arrive at a price at which they would be willing to assume risk with little or no knowledge of how other market participants would or have arrived at prices at which they have assumed or would be willing to assume risk. We preliminarily believe that, by reducing information asymmetries between non-dealers and persons acting in a dealing capacity and providing more equal access to post-trade information in the security-based swap market, implicit transaction costs could be reduced, which could in turn promote greater price efficiency.[327] Ensuring that post-trade information encompasses

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325 As discussed in the Regulation SBSR Adopting Release, dealing activity in the single-name CDS market is concentrated among a small number of firms that each enjoy informational advantages as a result of the large quantity of order flow they privately observe. Implicit transaction costs are the difference between the transaction price and the fundamental value, which could reflect adverse selection or could reflect compensation for inventory risk. In addition to these implicit transaction costs, security-based swap market participants may face explicit transaction costs such as commissions and other fees that dealers might charge non-dealers for access to the market. See Regulation SBSR Adopting Release, 80 FR 14704 n.1254.

326 See Regulation SBSR Adopting Release, 80 FR 14605.

327 Security-based swaps are complex derivative products, and there is no single accepted way to model a security-based swap for pricing purposes. As we noted in the Regulation SBSR Adopting Release, making post-trade pricing and volume information publicly available should allow valuation models to be adjusted to reflect how other market participants have valued a

transactions involving a non-U.S. person that arranged, negotiated, or executed the security-based swap in connection with its dealing activity using personnel located in a U.S. branch or office could increase price competition and price efficiency in the security-based swap market and should enable all market participants to have more comprehensive information with which to make trading and valuation determinations.[328]

(b) Security-based swaps executed on a platform having its principal place of business in the United States

We also are proposing to amend rule 908(a)(1) of Regulation SBSR by adding a provision that would require any security-based swap transaction that is executed on a platform[329] having its principal place of business in the United States both to be reported to a registered SDR and to be publicly disseminated pursuant to Regulation SBSR.[330] Under our previously re-proposed rule, such transactions generally would have been subjected to Regulation SBSR as "transactions conducted within the United States" under the proposed definition of that term.

As noted above, our proposed amendments to Regulation SBSR focus on transactions that a non-U.S. person, in connection with its dealing activity, arranges, negotiates, or executes

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security-based swap product at a specific moment in time. Public dissemination of last-sale information also should aid persons engaged in dealing activity in deriving better quotations, because they will know the prices at which other market participants have traded. Last-sale information also should aid end users and other non-dealing entities in evaluating current quotations, by allowing them to question why a dealer's quote differs from the prices of the most recent transactions. Furthermore, smaller market participants that view last-sale information should be able to test whether quotations offered by dealers before the last sale were close to the price at which the last sale was executed. In this manner, post-trade transparency should promote price competition and more efficient price discovery in the security-based swap market. See Regulation SBSR Adopting Release, 80 FR 14606.

328 See id.

329 Regulation SBSR defines "platform" to mean "a national securities exchange or security-based swap execution facility that is registered or exempt from registration." Rule 900(v).

330 See proposed rule 908(a)(1)(iii).

using personnel located in a U.S. branch or office rather than on the broader range of activity reflected in our proposed definition of "transaction conducted in the United States." We preliminarily continue to believe, however, that a transaction executed on a platform that has its principal place of business in the United States also should be subject to Regulation SBSR, even when the transaction involves two non-U.S. persons that are not engaged in dealing activity in connection with the transaction. Transactions executed on a platform having its principal place of business in the United States are consummated within the United States and therefore exist, at least in part, in the United States.[331] Requiring these security-based swaps to be reported to a registered SDR will permit the Commission and other relevant authorities to observe, in a registered SDR, all transactions executed on such a platform and to carry out oversight of such security-based swaps. Furthermore, we preliminarily believe that public dissemination of such transactions would have value to participants in the U.S. security-based swap market, who are likely to trade the same or similar products, as these products will have been listed by a platform having its principal place of business in the United States.

(c) Security-based swaps effected by or through a registered broker-dealer

We are also proposing to amend rule 901(a) of Regulation SBSR by adding a provision that would require the reporting and public dissemination of any security-based swap transaction

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[331] Cf. Regulation SBSR Adopting Release, 80 FR 14654 (noting that a security-based swap that is accepted for clearing by a clearing agency having its principal place of business in the United States also exists, at least in part, within the United States).

Requiring these transactions to be reported should enable registered SDRs to have a complete record of all security-based swaps that are executed on platforms that have their principal place of business in the United States, which should enhance our ability to monitor these platforms, and activity in the security-based swap market more generally, for manipulation and other abusive practices. Cf. Cross-Border Proposing Release, 78 FR 31040 (noting importance of having a complete record of security-based swaps). Requiring these transactions to be reported should also enhance our ability to monitor activity on these platforms for compliance with recordkeeping and reporting and other requirements. See Cross-Border Proposing Release, 78 FR 31183 (discussing the market-wide benefits of enhanced transparency).

that is effected by or through a registered broker-dealer (including a registered SB SEF).[332] As noted above, existing rule 908(a)(1) already provides that any transaction involving a U.S. person, either directly or indirectly, on one or both sides of the transaction subjects that transaction to both regulatory reporting and public dissemination; proposed rule 908(a)(1)(v) would impose the same requirements with respect to any transaction that a non-U.S. person in connection with its dealing activity arranges, negotiates, or executes using its personnel or the personnel of its agent located in a U.S. branch or office. Given the limitation on reporting duties set forth in rule 908(b) and in the proposed amendments to that rule, we expect that most, if not all, registered broker-dealers required to report under this proposed amendment would be U.S. persons intermediating security-based swap transactions between non-U.S. person counterparties and that such persons would be effecting transactions in security-based swaps from their offices in the United States. Moreover, under the proposed amendments to the reporting hierarchy described below, a registered broker-dealer (including a registered SB SEF) would be required to report transactions effected by or through it only when neither side of that transaction includes a U.S. person, neither side is a registered security-based swap dealer or registered major security-based swap participant, and neither side of that transaction involves a non-U.S. person that has, in connection with its dealing activity, arranged, negotiated, or executed the security-based swap using its personnel or the personnel of its agent located in a U.S. branch or office.[333]

332 See proposed rule 908(a)(1)(iv).

333 We acknowledge that some commenters urged us not to require SB SEFs to report transactions under Regulation SBSR. See note 289, supra. We preliminarily believe, however, that a registered broker-dealer (including a registered SB SEF) is likely to be better positioned to report than either counterparty to a transaction described in proposed rule 901(a)(2)(ii)(E)(4). We note that proposed rule 901(a)(2)(ii)(E)(4) applies only when two non-U.S. persons who are not registered security-based swap dealers, registered major security-based swap participants, or non-U.S. persons that fall within proposed rule 908(b)(5) effect a security-based swap through a registered broker-dealer. In the Regulation SBSR Adopting Release, we observed that non-

To the extent that a registered broker-dealer intermediates a security-based swap transaction, we preliminarily believe that the transaction should be both reported to a registered SDR and publicly disseminated. Registered broker-dealers play a key role as intermediaries in the U.S. financial markets. To improve integrity and transparency in those markets, we believe that it is important that the Commission, and other relevant authorities, have ready access to detailed information about the security-based swap transactions that such persons intermediate. Furthermore, we preliminarily believe that public dissemination of such transactions will have value to participants in the U.S. security-based swap market, who are likely to trade the same or similar products.

3. Application of the public dissemination requirement to certain transactions

In the Regulation SBSR Adopting Release, we adopted rule 908(a)(1)(i), which requires, among other things, public dissemination of all security-based swap transactions having a U.S.-person guarantor, including transactions in which the other side includes no counterparty that is a U.S. person, registered security-based swap dealer, or registered major security-based swap participant (a "covered cross-border transaction").[334] This represented a departure from the re-proposed approach described in the Cross-Border Proposing Release, which would have excepted covered cross-border transactions from the public dissemination requirement.[335] We

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registered persons are less likely than Commission registrants to have systems in place to support the reporting required by Regulation SBSR, and we preliminarily believe that the same applies here. See Regulation SBSR Adopting Release, 80 FR 14600.

334 See rule 908(a)(1)(i); Regulation SBSR Adopting Release, 80 FR 14652-53. As in the Regulation SBSR Adopting Release, a "covered cross-border transaction" refers to a transaction that meets the description above and will not be submitted to clearing at a registered clearing agency having its principal place of business in the United States. See Regulation SBSR Adopting Release, 80 FR 14653.

335 See Cross-Border Proposing Release, 78 FR 31062; initially re-proposed rule 908(a)(2) (requiring that security-based swaps be publicly disseminated if there is a direct or indirect counterparty that is a U.S. person on each side of the transaction).

noted, however, that we had determined to continue considering whether to except covered cross-border transactions from the public dissemination requirement and that we would solicit additional comment regarding whether such an exception would be appropriate. We solicit comment on this approach in the request for comments below.

In light of our determination to require all security-based swap transactions of U.S. persons, including all transactions conducted through a foreign branch, to be publicly disseminated, we preliminarily do not think that it would be appropriate to exempt covered cross-border transactions from the public dissemination requirement. As we have noted elsewhere, the transactions of a guaranteed non-U.S. person exist, at least in part, within the United States, and the economic reality of these transactions is substantially identical to transactions entered into directly by a U.S. person (including through a foreign branch).[336] Failure to require such transactions to be publicly disseminated would treat these economically substantially identical transactions differently, potentially creating competitive disparities between U.S. persons, depending on how they have structured their business, as a guaranteed non-U.S. person would be able to carry out an unlimited volume of covered cross-border transactions without being subject to the public dissemination requirement.[337]

4. Proposed amendments regarding limitations on reporting obligations of certain persons engaged in security-based swaps subject to Regulation SBSR

Rule 908(b) of Regulation SBSR provides that, notwithstanding any other provision of Regulation SBSR, a person shall not incur any obligation under Regulation SBSR unless it is a

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336 See note 319, supra.

337 However, if the transactions of a guaranteed non-U.S. person are subject to regulatory reporting and public dissemination requirements in a foreign jurisdiction that are comparable to those imposed by Regulation SBSR, such transactions could be eligible for substituted compliance. See rule 908(c).

U.S. person, a registered security-based swap dealer, or a registered major security-based swap participant.[338] We noted that rule 908(b) is designed to specify the types of persons that will incur duties under Regulation SBSR. If a person does not come within any of the categories enumerated by rule 908(b), it would not incur any duties under Regulation SBSR.[339] Rule 908(b) was designed to reduce assessment costs and provide greater legal certainty to counterparties engaging in cross-border security-based swaps, and we explained that we anticipated soliciting additional public comment regarding whether regulatory reporting and/or public dissemination requirements should be extended to transactions between non-U.S. persons occurring within the United States and, if so, which non-U.S. persons should incur reporting duties under Regulation SBSR.[340]

Consistent with the proposed amendments described above, and so that at least one counterparty to a transaction that is subject to Regulation SBSR has an obligation to report the transaction to a registered SDR, we are proposing to add subparagraph (5) to rule 908(b) to include a non-U.S. person that, in connection with such person's security-based swap dealing activity, arranged, negotiated, or executed the security-based swap using its personnel located in a U.S. branch or office, or using personnel of its agent located in a U.S. branch or office.[341]

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338 See rule 908(b). In the Regulation SBSR Proposed Amendments Release, we proposed to amend rule 908(b) by adding platforms and registered clearing agencies to the list of persons that might incur obligations under Regulation SBSR. See Regulation SBSR Proposed Amendments Release, 80 FR 14759.

339 See Regulation SBSR Adopting Release, 80 FR 14656.

340 See id.

341 See proposed rule 908(b)(5). We intend the proposed rule to indicate the same type of activity by personnel located in the United States as described in Section III.B.5, supra. Moreover, for purposes of proposed rule 908(b)(5), we would interpret the term "personnel" in a manner consistent with the definition of "associated person of a security-based swap dealer" contained in section 3(a)(70) of the Exchange Act, 15 U.S.C. 78c(a)(70), regardless of whether such non-U.S. person or such non-U.S. person's agent is itself a security-based swap dealer. See note 193, supra

Because existing rule 908(b)(2) already covers a non-U.S. person that is registered as a security-based swap dealer, the effect of proposed rule 908(b)(5) would be to cover a non-U.S. person that engages in dealing activity in the United States but that does not meet the de minimis threshold and thus would not be registered as a security-based swap dealer.

5. Proposed amendment regarding reporting duties of certain persons that are not registered security-based swap dealers or registered major security-based swap participants

Rule 901(a)(2)(ii) of Regulation SBSR establishes a reporting hierarchy that specifies the side that has the duty to report a security-based swap, taking into account the types of entities present on each side of the transaction.[342] The reporting side, as determined by the reporting hierarchy, is required to submit the information required by rule 901 of Regulation SBSR to a registered SDR.[343] The reporting side may select the registered SDR to which it makes the required report.

Rule 901(a)(2) of Regulation SBSR does not assign reporting obligations for certain transactions having only unregistered entities on both sides of the transaction. In the Regulation SBSR Adopting Release, we specifically noted that we anticipated soliciting further comment regarding the duty to report a security-based swap where neither side includes a registered security-based swap dealer or a registered major security-based swap participant and neither side includes a U.S. person or only one side includes a U.S. person.[344] In this release we are

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(discussing the Commission's proposed interpretation of the term "personnel" for purposes of proposed rule 3a71-3(b)(1)(iii)(C)).

342 See rule 901(a).

343 Rule 900(gg) defines "reporting side" to mean "the side of a security-based swap identified by § 242.901(a)(2)." As noted above, rule 901(a)(2) identifies the person that will be obligated to report a security-based swap under various circumstances.

344 See Regulation SBSR Adopting Release, 80 FR 14600, 14655.

proposing additional provisions setting forth which sides would have the duty to report such transactions.

As noted above, and as discussed in the Regulation SBSR Adopting Release, one commenter raised concerns about burdens that the previously re-proposed reporting hierarchy might place on U.S. persons in transactions with certain non-U.S.-person counterparties.[345] Under that approach, in a transaction between a non-U.S. person and a U.S. person, where neither side included a security-based swap dealer or major security-based swap participant, the U.S. person would have had the duty to report. The commenter noted that in such transactions the non-U.S.-person counterparty might be engaged in dealing activity but at levels below the security-based swap dealer de minimis threshold and the U.S. person may not be acting in a dealing capacity in any of its security-based swap transactions. The commenter argued that, in such cases, the non-U.S. person may be better equipped to report the transaction and accordingly that, when two non-registered persons enter into a security-based swap, the counterparties should be permitted to select which counterparty would report, even if one counterparty is a U.S. person.[346]

Proposed rule 901(a)(2)(ii)(E)(2) is intended in part to address this concern when the non-U.S. person is engaged in dealing activity using personnel located in the United States. Under the proposed rule, in a transaction between such a non-U.S. person and a U.S. person, where neither side includes a registered security-based swap dealer or a registered major security-based swap participant, the sides would be permitted to select which side has the duty to

345 See IIB Letter at 26; Regulation SBSR Adopting Release, 80 FR 14600.

346 See IIB Letter at 26 (stating that, in such transactions, "it would be more efficient and fair for the Commission to modify its rules to allow a De Minimis SBSD to agree with its counterparty to be the reporting party when facing a U.S. non-registrant counterparty").

report the transaction.[347] We preliminarily believe that this approach should facilitate efficient allocation of reporting duties between the sides by permitting the counterparties to select the reporting side.

For similar reasons, proposed rule 901(a)(2)(ii)(E)(2) also provides that, in a transaction between two non-U.S. persons in which both sides include a non-U.S. person that is carrying out relevant security-based swap dealing activity using personnel located in a U.S. branch or office, as described in proposed rule 908(b)(5), the sides would be permitted to select which side has the duty to report the transaction. We preliminarily believe that, because both sides of such a transaction are engaging in dealing activity in the United States but both fall beneath the de minimis thresholds, both sides are likely to have approximately equivalent levels of infrastructure to support their U.S. business, including the infrastructure for reporting transactions to a registered SDR. In such cases, we preliminarily believe that it would be reasonable and appropriate to permit them to select which side will have the duty to report.[348]

With respect to transactions in which one side includes only unregistered non-U.S. persons that do not fall within proposed rule 908(b)(5) and the other side includes at least one unregistered non-U.S. person that does fall within proposed rule 908(b)(5) or one unregistered U.S. person, we preliminarily believe that it is appropriate to place the reporting duty on the side that includes the unregistered non-U.S. person that falls within proposed rule 908(b)(5) or the

347 See proposed rule 901(a)(2)(ii)(E)(2).

348 Similar considerations have informed our proposal to permit counterparties to a transaction where both sides include only non-U.S. persons that do not fall within proposed rule 908(b)(5) to select the reporting side. See proposed rule 901(a)(2)(ii)(E)(4). Such a transaction would be subject to Regulation SBSR because it has been accepted for clearing by a clearing agency that has its principal place of business in the United States or because it has been executed on a platform that has its principal place of business in the United States. See proposed rules 908(a)(ii) and (iii).

unregistered U.S. person.[349] We preliminarily believe that, in such a transaction, the U.S. person or the non-U.S. person engaged in a security-based swap transaction, in connection with its dealing activity, using personnel located in a U.S. branch or office may generally be more likely than its counterparty to have the ability to report the transaction to a registered SDR given that it has operations in the United States. We also note that, in a transaction where neither side includes a registered security-based swap dealer or a registered major security-based swap participant, placing the duty on the side that has a presence in the United States should better enable us to monitor and enforce compliance with the reporting requirement.

Finally, we are proposing a rule that would provide that a registered broker-dealer (including a registered SB SEF) shall report the information required by rules 901(c) and 901(d) for any transaction in which neither side includes a U.S. person and neither side includes a non-U.S. person that falls within proposed rule 908(b)(5) but the security-based swap is effected by or through the registered broker-dealer (including a registered SB SEF).[350] We preliminarily believe that, in such a transaction, the registered broker-dealer (including a registered SB SEF) may generally be more likely than the counterparties to the transaction (neither of which may have any operations or presence in the United States) to have the ability to report the transaction to a registered SDR given its presence in the United States and its familiarity with the Commission's regulatory requirements.[351]

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349 See proposed rule 901(a)(2)(ii)(E)(3).

350 See proposed rule 901(a)(2)(ii)(E)(4).

351 Cf. Letter from ISDA to SEC, dated January 18, 2011 ("ISDA/SIFMA Letter") at 17 (noting that market participants, including brokers, may provide reporting services on behalf of their customers).

6. Proposed amendments to rules 900(u), 901(d)(9), 906(b), 906(c), and 907(a) of Regulation SBSR to accommodate proposed rule 901(a)(2)(ii)(E)(4).

(a) Proposed amendment to rule 900(u)

Rule 900(u) defines a "participant" of a registered SDR as "a counterparty, that meets the criteria of [rule 908(b) of Regulation SBSR], of a security-based swap that is reported to that [registered SDR] to satisfy an obligation under [rule 901(a) of Regulation SBSR]." In the Regulation SBSR Proposed Amendments Release, we proposed to expand the definition of "participant" to include registered clearing agencies and platforms.[352] This proposed definition would not include a registered broker-dealer that incurs reporting obligations solely because it effects a transaction between unregistered non-U.S. persons that do not fall within proposed rule 908(b)(5). We believe that such registered broker-dealers should be participants of any registered SDR to which they are required to report security-based swap transaction information. Imposing participant status on such registered broker-dealers would explicitly require those entities to report security-based swap transaction information to a registered SDR in a format required by that registered SDR under rule 901(h). If such registered broker-dealers were not participants of the registered SDR and were permitted to report data in a format of their own choosing, it could be difficult or impossible for the registered SDR to understand individual transaction reports or aggregate them with other reports in a meaningful way. This could adversely affect the ability of the Commission and other relevant authorities to carry out their oversight responsibilities and could interfere with the ability of a registered SDR to publicly

352 See Regulation SBSR Adopting Release, 80 FR 14751. As proposed to be amended, rule 900(u) would define "participant" to mean: (1) a person that is a counterparty to a security-based swap, provided that the security-based swap is subject to regulatory reporting under Regulation SBSR and is reported to a registered SDR pursuant to Regulation SBSR; (2) a platform that is required to report a security-based swap pursuant to Rule 901(a)(1); or (3) a registered clearing agency that is required to report a life cycle event pursuant to Rule 901(e).

disseminate security-based swap transaction information as required by rule 902 of Regulation SBSR. Therefore, we are proposing to amend the definition of "participant" in rule 900(u) to include a registered broker-dealer that is required to report a security-based swap by rule 901(a)(2)(ii)(E)(4).

If we ultimately adopt both this amendment to rule 900(u) and the amendment proposed in the Regulation SBSR Proposed Amendments Release, "participant" would mean: "with respect to a registered security-based swap data repository, [] (1) a counterparty, that meets the criteria of § 242.908(b), of a security-based swap that is reported to that registered security-based swap data repository to satisfy an obligation under § 242.901(a); (2) a platform that reports a security-based swap to that registered security-based swap data repository to satisfy an obligation under § 242.901(a); (3) a registered clearing agency that is required to report to that registered security-based swap data repository whether or not it has accepted a security-based swap for clearing pursuant to § 242.901(e)(1)(ii); or (4) a registered broker-dealer (including a registered security-based swap execution facility) that is required to report a security-based swap to that registered security-based swap data repository by § 242.901(a)."

(b) Proposed amendment to rule 901(d)(9)

In the Regulation SBSR Adopting Release, we noted the importance of identifying whether a broker is involved in the execution of a security-based swap. Identifying the broker for a security-based swap will provide regulators with a more complete understanding of the transaction and could provide useful information for market surveillance purposes.[353] To obtain information about brokers that facilitate security-based swap transactions—as well as other persons involved in a security-based swap—existing rule 901(d)(2) requires the reporting side to

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353 See Regulation SBSR Adopting Release, 80 FR 14583.

report, as applicable, the branch ID, broker ID, execution agent ID, trade ID, and trading desk ID of the direct counterparty on the reporting side. In the Regulation SBSR Adopting Release, we also recognized the importance of identifying the venue on which a security-based swap is executed, because this information should enhance the ability of relevant authorities to conduct surveillance in the security-based swap market and understand developments in the security-based swap market generally.[354] Therefore, we adopted rule 901(d)(9), which requires reporting of the platform ID, if applicable.

As described above, proposed rule 901(a)(2)(ii)(E)(4) would require a registered broker-dealer to report the information in rules 901(c) and 901(d) for any transaction between two unregistered non-U.S. persons that do not fall within rule 908(b)(5) where the transaction is effected by or through the registered broker-dealer. Because a security-based swap reported under rule 901(a)(2)(ii)(E)(4) will not have a reporting side, no one would have the obligation to report the information required by existing rule 901(d)(2). We preliminarily believe, however, that being able to identify any registered broker-dealer that effects a security-based swap transaction in the manner described in rule 901(a)(2)(ii)(E)(4) would enhance our understanding of the security-based swap market and would improve our ability, and the ability of other relevant authorities, to conduct surveillance of security-based swap market activities. We therefore propose to amend rule 901(d)(9) to assure that the identity of any such registered broker-dealer is included in the report of a security-based swap transaction reported pursuant to rule 901(a)(2)(ii)(E)(4). As proposed to be amended, rule 901(d)(9) would require reporting of "[t]he platform ID, if applicable, or if a registered broker-dealer (including a registered security-based swap execution facility) is required to report the security based swap by §

354 See Regulation SBSR Adopting Release, 80 FR 14589.

242.901(a)(2)(ii)(E)(4), the broker ID of that registered broker-dealer (including a registered security-based swap execution facility)."

(c) Proposed amendments to rules 906 and 907

Under the proposed amendment to rule 900(u) described above,[355] the definition of "participant" would be expanded to include a registered broker-dealer that incurs reporting obligations solely because it effects a transaction between two unregistered non-U.S. persons that do not fall within proposed rule 908(b)(5). Rule 906(b) of Regulation SBSR generally requires a participant of a registered SDR to provide the identity of its ultimate parent and any affiliates that also are participants of that registered SDR. In the Regulation SBSR Proposed Amendments Release, we proposed to except platforms and registered clearing agencies from rule 906(b).[356] We preliminarily believe that the purposes of rule 906(b)—namely, facilitating our ability to measure derivatives exposure within the same ownership group—would not be advanced by applying the requirement to a registered broker-dealer that incurs reporting obligations solely because it effects a transaction between two unregistered non-U.S. persons that do not fall within proposed rule 908(b)(5) to report parent and affiliate information to a registered SDR. A registered broker-dealer acting solely as a broker with respect to a security-based swap is not taking a principal position in the security-based swap. To the extent that such a registered broker-dealer has an affiliate that transacts in security-based swaps, such positions could be derived from other transaction reports indicating that affiliate as a counterparty. Accordingly, we propose to amend rule 906(b) to state that reporting obligations under rule 906(b) do not

[355] See Section V.E.6, supra.

[356] See Regulation SBSR Adopting Release, 80 FR 14645-46.

apply to a registered broker-dealer that becomes a participant solely as a result of making a report to satisfy an obligation under rule 901(a)(2)(ii)(E)(4).

We propose to make a similar amendment to rule 907(a)(6). In the Regulation SBSR Proposed Amendments Release, we proposed to amend this rule to require a registered SDR to have policies and "[f]or periodically obtaining from each participant other than a platform or a registered clearing agency information that identifies the participant's ultimate parent(s) and any participant(s) with which the participant is affiliated, using ultimate parent IDs and counterparty IDs."[357] We now propose to further amend rule 907(a)(6) and except from this requirement a registered broker-dealer that incurs reporting obligations solely because it effects a transaction between two unregistered non-U.S. persons that do not fall within proposed rule 908(b)(5). Thus, if we ultimately adopt both this amendment to rule 907(a)(6) and the amendment to rule 907(a)(6) proposed in the Regulation SBSR Proposed Amendments Release, rule 907(a)(6) would require a registered SDR to have policies and procedures "[f]or periodically obtaining from each participant other than a platform, a registered clearing agency, or a registered broker-dealer (including a registered security-based swap execution facility) that becomes a participant solely as a result of making a report to satisfy an obligation under § 242.901(a)(2)(ii)(E)(4) information that identifies the participant's ultimate parent(s) and any participant(s) with which the participant is affiliated, using ultimate parent IDs and counterparty IDs."

(d) Extending the applicability of rule 906(c)

Rule 906(c) requires certain participants of a registered SDR to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure that the

357 Once a participant reports parent and affiliate information to a registered SDR, rule 906(b) requires the participant to "promptly notify the registered [SDR] of any changes" to its parent and affiliate information.

participant complies with any obligations to report information to a registered SDR in a manner consistent with Regulation SBSR. Rule 906(c) also requires participants covered by the rule to review and update their policies and procedures at least annually. In the Regulation SBSR Adopting Release, we stated that the policies and procedures required by rule 906(c) are intended to promote complete and accurate reporting of security-based swap information by SDR participants that are registered security-based swap dealers or registered major security-based swap participants.[358]

In the Regulation SBSR Proposed Amendments Release, we proposed to amend rule 906(c) by extending the requirement to have such policies and procedures to platforms and registered clearing agencies.[359] In light of the proposed amendments to rule 901(a) relating to registered broker-dealers, described above, we now preliminarily believe that a registered broker-dealer that incurs reporting obligations solely because it effects transactions between two unregistered non-U.S. persons that do not fall within proposed rule 908(b)(5) also should be required to establish, maintain, and enforce the policies and procedures required by rule 906(c).[360]

We preliminarily believe that the proposed amendment to rule 906(c) should result in greater accuracy and completeness of the security-based swap transaction data reported to registered SDRs. Without written policies and procedures, compliance with reporting

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358 See Regulation SBSR Adopting Release, 80 FR 14648.

359 See id. at 14758-59.

360 We are also proposing to revise the title of the rule. As adopted, the title of rule 906(c) was: "Policies and procedures of registered security-based swap dealers and registered major security-based swap participants." In the Regulation SBSR Proposed Amendments Release, we proposed to add registered clearing agencies and platforms to the rule's title. Rather than adding registered broker-dealers to the entities delineated in the title to 906(c), we are proposing to revise the title to "Policies and procedures to support reporting compliance."

obligations of such a registered broker-dealer might depend too heavily on key individuals or unreliable processes. For example, if knowledge of the reporting function was not reflected in written policies and procedures but existed solely in the memories of one or a few individuals, compliance with applicable reporting requirements by the firm might suffer if these key individuals depart the firm. We preliminarily believe, therefore, that requiring participants that are registered broker-dealers that incur reporting obligations solely because they effect a transaction between two non-U.S. persons that do not fall within proposed rule 908(b)(5) to establish, maintain, and enforce written policies and procedures should promote clear, reliable reporting that can continue independent of any specific individuals. We further believe that requiring such a participant to establish, maintain, and enforce written policies and procedures relevant to its reporting responsibilities, as would be required by the proposed amendment to rule 906(c), would help to improve the degree and quality of overall compliance with the reporting requirements of Regulation SBSR.

7. Availability of substituted compliance

Rule 908(c)(1) of Regulation SBSR describes the security-based swap transactions that potentially would be eligible for substituted compliance with respect to regulatory reporting and public dissemination of security-based swap transactions. Accordingly, substituted compliance would potentially be available for transactions that would become subject to Regulation SBSR pursuant to the proposed amendments described above, as the location of relevant dealing activity or of execution of the transaction would continue to be irrelevant for purposes of rule 908(c).[361]

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[361] See note 295, supra.

Rule 908(c)(1) does not condition substituted compliance eligibility on where a particular transaction was arranged, negotiated, or executed.[362] Under rule 908(c)(1), a security-based swap is eligible for substituted compliance with respect to regulatory reporting and public dissemination, provided that at least one of the direct counterparties to the security-based swap is either a non-U.S. person or a foreign branch. Thus, rule 908(c)(1) permits a security-based swap between a U.S. person and the New York branch of a foreign bank (i.e., a non-U.S. person with operations inside the United States) to be eligible for substituted compliance, provided that such compliance is with the rules of a foreign jurisdiction that is the subject of a Commission substituted compliance order.

In adopting rule 908(c)(1), we noted that the final rule was consistent with our decision to solicit additional comments regarding whether to impose reporting or public dissemination requirements based solely on whether a transaction is conducted within the United States.[363] Although we are now proposing an amendment that would impose these requirements on certain transactions that a non-U.S. person arranges, negotiates, or executes using personnel located in a U.S. branch or office, we are not proposing an amendment that would limit the availability of substituted compliance for such transactions based on the location of this relevant activity. Accordingly, under our proposed approach, and consistent with our final rule, counterparties to a transaction that is required to be reported because a non-U.S.-person counterparty to the transaction, in connection with its dealing activity, arranged, negotiated, or executed the

362 Rule 908(c)(1) provides: "Compliance with the regulatory reporting and public dissemination requirements in sections 13(m) and 13A of the Act (15 U.S.C. 78m(m) and 78m-1), and the rules and regulations thereunder, may be satisfied by compliance with the rules of a foreign jurisdiction that is the subject of a Commission order described in paragraph (c)(2) of this section, provided that at least one of the direct counterparties to the security-based swap is either a non-U.S. person or a foreign branch."

363 See Regulation SBSR Adopting Release, 80 FR 14658.

transaction using personnel located in a U.S. branch or office or because it was executed on a platform or effected by or through a registered broker-dealer would be eligible for substituted compliance, provided that such compliance is with the rules of a foreign jurisdiction that is the subject of a Commission order.[364]

This approach would subject transactions that are arranged, negotiated, or executed by personnel located in a U.S. branch or office, in connection with a non-U.S. person's dealing activity, to regulatory reporting and public dissemination requirements in a manner consistent with Title VII, while mitigating the potential to duplicate compliance burdens. The proposed approach is also consistent with the determination in our final rule that certain transactions involving U.S.-person counterparties are eligible for substituted compliance (i.e., when the transaction is through the foreign branch of the U.S. person) even if the non-U.S.-person counterparty has engaged in dealing activity in connection with the transaction in the United States.[365]

F. Request for Comment

We invite comment regarding all aspects of the proposed approach to clearing, trade execution, regulatory reporting, and public dissemination described here, as well as potential alternative approaches. Data and comment from market participants and other interested parties regarding the likely effect of the proposed approach and of potential alternative approaches will be particularly useful to us in evaluating potential modifications to the re-proposal.

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364 A non-U.S. person engaged in relevant dealing activity using personnel located in a U.S. branch or office may incur the duty to report a transaction under Exchange Act rules 901(a)(2)(ii)(A), (B), (C), or (D), or under proposed rules 901(a)(2)(ii)(E)(2), (3), or (4) of Regulation SBSR.

365 See Exchange Act rule 908(c)(1) (permitting compliance with the regulatory reporting and public dissemination requirements by complying with the rules of a foreign jurisdiction if at least one of the direct counterparties to the security-based swap transaction is either a non-U.S. person or a foreign branch).

In addition, we specifically request comment with respect to each of the requirements discussed above, as follows.

1. Mandatory clearing and trade execution

We seek comment on the re-proposed rule regarding application of mandatory clearing and trade execution in all aspects, including the following:

- Is it appropriate not to apply the clearing and trade execution requirements to transactions that a non-U.S. person, in connection with its dealing activity, arranges, negotiates, or executes using personnel located in a U.S. branch or office? Why or why not?
- What would be the likely market impact of our proposal not to subject such transactions to the clearing and trade execution requirements? How would this proposed approach affect the competitiveness of U.S. persons and other market participants in the global marketplace (both in the United States as well as in foreign jurisdictions)? How do you believe any competitive disparity that may result under our proposed approach should be addressed by our rules?
- Would there be any potential effect from our proposal on U.S. financial stability? If so, how should any such effect be addressed?
- Would there be any potential effect from our proposal on the liquidity available on any SB SEFs? If so, how should any such effect be addressed?
- To what extent do non-U.S. persons that are not engaged in security-based swap dealing but do enter into security-based swaps with dealers that use personnel located in the United States already have clearing relationships with clearing agencies located in the United States or with entities that may qualify for a

substituted compliance determination? For such persons that do not already have such relationships, what costs and other burdens would be involved with establishing such relationships? To what extent would permitting substituted compliance as proposed in the Cross-Border Proposing Release address these concerns?

2. Regulation SBSR

We request comment on all aspects of the proposed amendments to Regulation SBSR, including the following:

- Do you agree with the approach taken in the proposed amendments to rule 908(a) that a security-based swap should be subject to regulatory reporting and public dissemination regardless of the nationality or place of domicile of the counterparties if it is a transaction connected with a person's security-based swap dealing activity that is arranged, negotiated, or executed by personnel located in the United States? Why or why not?
- Do you agree with the approach taken in the proposed amendments to rule 908(a) that a security-based swap executed on a platform having its principal place of business in the United States should be subject to the regulatory reporting and public dissemination requirements? Why or why not?
- Do you agree with the approach taken in the proposed amendments to rule 908(a) that would subject a security-based swap effected by or through a registered broker-dealer (including a registered security-based swap execution facility) to the regulatory reporting and public dissemination requirements? Why or why not? Should transactions that would be required to be reported under the

proposed amendments to rule 908(a) solely because they were effected by or through a registered broker-dealer (including a registered security-based swap execution facility) be required to be reported by a counterparty to the transaction, rather than by a registered broker-dealer (including a registered security-based swap execution facility), as proposed?

- Do you agree with the proposed amendment to the hierarchy of reporting obligations in rule 901(a)? Why or why not? Are there any prongs where you believe the result should be different? If so, which prong(s) and why?
- Should we provide an exemption from Regulation SBSR's public dissemination requirement for transactions having a U.S. person guarantor in which the other side includes no counterparty (direct or indirect) that is a U.S. person, registered security-based swap dealer, or registered major security-based swap participant? Why or why not?
- What types of controls would be necessary to identify transactions required to be reported under rule 908(a)(1)(v)? How would this work as an operational matter? What are the costs and benefits associated with developing and maintaining such controls?
- As noted above, given the limitation on reporting duties set forth in rule 908(b) and in the proposed amendments to that rule, we expect that most, if not all, registered broker-dealers required to report under this proposed amendment would be U.S. persons intermediating security-based swap transactions between non-U.S. person counterparties and that such persons would be effecting transactions in security-based swaps from their offices in the United States. Is

this expectation consistent with market practices by registered broker-dealers?

- Should a registered broker-dealer that is required to report transactions pursuant to rule 901(a)(2)(ii)(E)(4) be a participant of the registered SDRs to which they report? If not, how would a registered SDR ensure that such persons provide data in a format required by the registered SDR? Would a registered broker-dealer likely be required to be a participant of a registered SDR under existing rule 901(d) by virtue of its other security-based swap activity?
- Do you agree that the Commission should require reporting of the identity of any registered broker-dealer that effects a security-based swap for two non-U.S. person that do not fall within rule 908(b)(5)? Why or why not? If so, do you believe that the proposed amendment to rule 901(d)(9) is the appropriate way to accomplish that goal? Why or why not?
- Do you agree with the Commission's proposal to exclude registered broker-dealers that incur reporting obligations solely because they effect a transaction between two non-U.S. persons that do not fall within proposed rule 908(b)(5) from rule 906(b)? Why or why not?
- Do you believe that rule 906(c) should be expanded to include registered broker-dealers that incur reporting obligations solely because they effect a transaction between two non-U.S. persons that do not fall within proposed rule 908(b)(5)? Why or why not?
- What would be the costs to registered broker-dealers that would be subject to rule 901(a)(2)(ii)(E)(4) for establishing and maintaining policies and procedures under rule 906(c) to support compliance with Regulation SBSR? Are these registered

broker-dealers likely to have affiliates that will become registered security-based swap dealers, which are already subject to rule 906(c)? If so, would these registered broker-dealers be able to reduce implementation burdens under rule 906(c) by adapting the policies and procedures of their affiliates for their own usage?

VI. Economic Analysis of the Proposed Rules

The proposed amendments and proposed rule would determine when a non-U.S. person whose obligations under a security-based swap are not guaranteed by a U.S. person and that is not a conduit affiliate is required to include in its dealer de minimis calculation transactions with another non-U.S. person and when transactions of a non-U.S. person whose obligations under a security-based swap are not guaranteed by a U.S. person are subject to the external business conduct requirements and to Regulation SBSR.

We are sensitive to the economic consequences and effects, including costs and benefits, of our rules. The following economic analysis identifies and considers the costs and benefits—including the effects on efficiency, competition, and capital formation—that may result from the rules being proposed today. These costs and benefits are discussed below and have informed the policy choices described throughout this release. Because of the attributes of the security-based swap market, the market's global nature, the concentration of dealing activity, and the ease with which dealers can relocate their operations to different jurisdictions, we preliminarily believe that the territorial approach to transactions proposed in these rules is consistent with the statutory focus of the Title VII framework for security-based swaps. Below, we discuss the likely economic effects of the proposed rules, including the assessment and programmatic costs and benefits. We also discuss the potential economic effects of certain alternatives to the approach taken by the proposed rules.

A. Assessment Costs

1. Discussion

Under the proposed rules we preliminarily believe that non-U.S. persons would incur costs to assess whether their activities must be counted against de minimis thresholds and subjected to Title VII requirements.[366] This section begins by considering the effect on assessment costs of increasing the scope of transactions required to be counted towards de minimis thresholds and proceeds to consider the effect on assessment costs of identifying security-based swap activity that, under the proposed rules, would count towards de minimis thresholds or become subject to external business conduct, regulatory reporting, and public dissemination requirements.

Because the proposed amendment would expand the scope of security-based swap transactions that non-U.S. persons would need to include in their de minimis calculations, we preliminarily believe that the proposed amendment may result in an increase in the number of non-U.S. persons exceeding $2 billion in transaction notional in a given year and incurring assessment costs as a result of counting transactions against the de minimis threshold.[367]

Estimating the number of additional non-U.S. persons that we expect to incur assessment costs as a result of the proposed amendment would require adding transactions arranged, negotiated, or executed by personnel located in the United States, including cleared anonymous

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366 We refer to these costs as "Assessment Costs." See Intermediary Definitions Adopting Release, 77 FR 30722.

367 We preliminarily believe that it is likely that entities that exceed $2 billion in transaction notional in a 12 month period are likely to incur assessment costs to determine whether they exceed the de minimis threshold. Because the proposed rules add to the set of transactions that must be counted towards the de minimis threshold, non-U.S. persons are more likely to exceed $2 billion in transaction notional and incur these assessment costs. These non-U.S. persons would have to assess not only transactions scoped in by the proposed rule, but also transactions with U.S. persons against their de minimis threshold. See Cross-Border Adopting Release, 79 FR 47331-33.

transactions subject to proposed rule 3a71-5(c), to the set of transactions that these non-U.S. persons are currently required to count as a result of rule 3a71-3(b)(1)(iii) and computing the total notional value of these transactions. We cannot determine, based on the TIW transactions data, whether particular transactions were arranged, negotiated, or executed by personnel located in the United States. If we assume that all observable transactions of non-U.S. persons on U.S. reference entities that are not already required to be applied towards the de minimis threshold as a result of proposed rule 3a71-3(b)(1)(iii) are arranged, negotiated, or executed by personnel located in a U.S. branch or office, we estimate that a total of approximately 15 non-U.S. persons likely would incur assessment costs as a result of the proposed amendment based on 2014 TIW transactions data. However, we note that this estimate may be overinclusive, as we do not believe that all such transactions are likely to be arranged, negotiated, or executed by personnel located in a U.S. branch or office, and at the same time it may also be underinclusive because our TIW data does not include single-name CDS transactions between two non-U.S. entities written on non-U.S. underliers.[368]

The additional 15 non-U.S. persons that are likely to incur assessment costs associated with de minimis counting would join the 56 non-U.S. persons identified in the TIW 2014 transactions data as having relevant activity under rule 3a-71-3(b),[369] for a total of 71 persons who would likely incur assessment costs under the proposed rules based on 2014 data. We preliminarily believe it is reasonable to increase these estimates by a factor of two, to account for any potential growth in the security-based swap market and to account for the fact that we are limited to observing transaction records for activity between non-U.S. persons that reference

368 We note that TIW's definitions of U.S. and non-U.S. entities do not necessarily correspond to the definition of U.S. person under Rule 3a71-3(a)(4).

369 See Section II.B.1(c).

U.S. underliers.[370] As a result, we preliminarily believe that the assessment costs discussed below apply to 142 entities.

Although foreign security-based swap dealers that are required to register under existing Exchange Act rule 3a71-3 would not be likely to incur assessment costs as a result of 3a71-3(b)(1)(iii), as this proposed rule would not affect their need to register as security-based swap dealers, they are included in our total estimate of 142 entities above. We have included them because they likely would incur identical assessment costs in order to identify transactions subject to those requirements under proposed Exchange Act rule 3a71-5(c), which imposes external business conduct requirements on the U.S. business of registered security-based swap dealers, and the proposed amendments to Regulation SBSR.

As noted above, we preliminarily believe that, as a result of the proposed rules, non-U.S. persons would incur costs to identify transaction activity that is relevant for de minimis counting and subject to external business conduct, regulatory reporting, and public dissemination requirements. We preliminarily believe that the business structures employed by non-U.S. persons may determine the magnitude of these assessment costs, and that non-U.S. persons will generally choose a business structure that considers its regulatory costs for both compliance and assessment. The following section discusses the approaches that these market participants may use to determine which transactions are subject to Title VII regulation under our proposed approach and, to the extent possible, presents estimates of assessment costs on a per-entity basis.

First, non-U.S. persons may perform assessments on a per-transaction basis, which some commenters have suggested could lead market participants to incur significant costs.[371] We

[370] See Intermediary Definitions Adopting Release, 77 FR 30725 n.1457.

recognize that performing these assessments could involve one-time costs associated with developing computer systems to capture information about the location of personnel involved with each transaction in addition to ongoing costs of analyzing these data and modifying classification of transaction activity as personnel or offices change locations over time. However, we preliminarily believe that the approach we are proposing in this release should considerably mitigate these costs. This proposed approach should be considerably easier than the initially proposed approach for market participants to integrate into existing transaction monitoring systems or order management systems given its focus on market-facing activity of personnel of the entity (or personnel of the agent of the entity) engaged in dealing activity that is located in the United States.

Accordingly, based on staff understanding regarding the development and modification of information technology (IT) systems that track the location of firm inputs, we preliminarily estimate the start-up costs associated with developing and modifying these systems to track the location of persons with dealing activity will be $410,000 for the average non-U.S. entity. To the extent that non-U.S. persons already employ such systems, the costs of modifying such IT systems may be lower than our estimate.

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371 See note 289, supra (citing ISDA Letter); note 108, supra (citing SIFMA/FIA/FSR Letter); note 109, supra (citing AFR Letter); notes 110 and 112, supra (citing IIB Letter). Other commenters noted the additional cost burden that market participants would face if the definition diverged from that of the CFTC. See note 111 (citing SIFMA/FIA/FSR Letter, Pensions Europe Letter, IIB Letter, and JFMC Letter). Comments on the CFTC Cross-Border Guidance also identified the issue of costs associated with an activity-based approach. See notes 131 and 133-134, supra (citing letters raising this concern).

In addition to the development or modification of IT systems, we preliminarily believe that entities would incur the cost of $6500 per year on an ongoing basis for training, compliance, and verification costs.[372]

Second, non-U.S. firms might additionally restrict personnel located in the United States from arranging, negotiating, or executing security-based swaps in connection with the non-U.S. firm's dealing activity with non-U.S.-person counterparties. Such restrictions on communication and staffing for the purposes of avoiding certain Title VII requirements would reduce the costs of assessing the territorial status of each trade, and may entirely remove the need for a system that assesses the location of personnel on a trade-by-trade basis. However, this reduction in assessment costs may be offset by the additional costs of duplicating personnel in foreign and U.S. locations.

While we do not currently have data necessary to precisely estimate these costs in total, we can estimate the costs of establishing policies and procedures to restrict communication between personnel located in the United States employed by non-U.S. persons (or their agents,) and other personnel involved in dealing activity. Based on staff experience, we preliminarily estimate that establishing policies would take a non-U.S. person approximately 100 hours and would cost approximately $28,300 for each entity that chooses this approach.[373] Further, we

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372 Calculated as Internal Cost, 90 hours x $50 per hour = $4,500 plus Consulting Costs, 10 hours x $200 per hour = $2,000, for a total cost of $6,500.

373 Calculated as Compliance Manager, 100 hours x $283 per hour = $28,300. We use salary figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by SEC staff to account for an 1,800-hour work-week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

The costs of policies and procedures are based on burden estimates in the recent Nationally Recognized Statistical Rating Organizations; Final Rule, Exchange Act Release No. 72936 (August 27, 2014), 79 FR 55078 (September 15, 2015) ("NRSRO Adopting Release"). Specifically, we assume that the policies and procedures required to restrict communication between U.S. and non-U.S. personnel are similar to policies and procedures required to eliminate preliminarily believe that the total costs incurred by entities that choose to restrict communication between personnel would be determined by the number of entities that choose such an approach as well as the number of additional personnel that these entities must hire as a result of restricted communication.

We preliminarily believe that non-U.S. persons that primarily trade with non-U.S. persons on non-U.S. reference entities may be most likely to undertake this approach. However, because our access to TIW transactions data is limited to transactions in which at least one counterparty is U.S.-domiciled or the reference entity is a U.S. entity, we cannot at this time estimate the size of this set of participants.

Third, a dealer may choose to comply with applicable Title VII requirements, regardless of whether they in fact apply, to avoid assessing the locations of personnel involved with each transaction. This strategy may be preferred by a non-U.S. person engaged in dealing activity that expects few transactions involving other non-U.S. persons to be arranged, negotiated, and executed by personnel located outside the United States, such as a non-U.S. person that primarily trades in U.S. reference entities and generally relies on personnel located in the United States to perform market-facing activities. For these participants, the savings from not following policies and procedures developed for Title VII compliance purposes for the few transactions that do not involve dealing activity by personnel from a location in the United States might be less costly than the costs of implementing a system to track the locations of personnel on a trade-by-trade basis. Similarly, registered foreign security-based swap dealers may also prefer this approach, as they would only be required to comply with Title VII external business conduct requirements,

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conflicts of interest under Rule 17g-5(c)(8). See NRSRO Adopting Release, 79 FR 55239, 55249.

and their security-based swap transactions, which would already be required to be reported under Regulation SBSR, also would be publicly disseminated.

We preliminarily believe that the same principles apply to non-U.S. persons that rely on agents to arrange, negotiate, or execute security-based swaps on their behalf. We anticipate that these agents of non-U.S. persons may employ any of the strategies above to comply with the proposed rules. Non-U.S. persons may rely on representations from their agents about whether transactions conducted on its behalf contained dealing activity by personnel from a location in the United States. This may occur on a transaction-by-transaction basis, or, if the agent complies with Title VII requirements by default, via a representation about the entirety of the agent's business.

We preliminarily believe that all the methods described above are likely to involve an initial one-time review of security-based swap business lines to help each entity determine which of the business structures outlined above is optimal. This review would encompass both employees of potential registrants as well as employees of agents used by potential registrants and would identify whether these personnel are involved in arranging, negotiating, or executing security-based swaps. The information gathered as a result of this review would allow a foreign security-based swap dealer to assess the revenues it expects to flow from transaction activity performed by personnel located in the United States. This information would also help these market participants form preliminary estimates about the costs associated with various alternative structures, including the trade-by-trade analysis outlined below. This initial review may be followed with reassessment at regular intervals or subsequent to major changes in the market participant's security-based swap business, such as acquisition or divestiture of business units. We preliminarily believe that this type of review of business lines would be similar in nature to the analysis needed to produce financial statements for a large financial institution. However, we acknowledge that evaluating alternative structures to determine costs associated with assessment and compliance may require additional legal analysis. We preliminarily estimate that the per-entity initial costs of a review of business lines would be approximately $102,000.[374] Further, we preliminarily believe that periodic reassessment of business lines would cost, on average, $52,000 per year, per entity.[375]

Additionally, we preliminarily believe that our proposed approach may impose certain costs on U.S. security-based swap dealers conducting business through a foreign branch, and registered broker-dealers (including registered SB SEFs) that intermediate trade in the security-based swap market. First, under the proposed approach, U.S. security-based swap dealers conducting business through a foreign branch will also need to classify their counterparties and transactions in order to determine what activity constitutes their foreign business. Based on analysis of 2014 TIW transactions data, we continue to estimate that no more than five security-based swap dealers will conduct dealing activity through foreign branches. Assuming that all such entities elect to establish a system to identify their foreign business, we preliminarily estimate the total assessment costs associated with the proposed approach to be approximately $75,000, with ongoing, annual costs of approximately $84,000.[376]

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374 Calculated as (Senior Accountant, 500 hours x $198 per hour) + (Compliance Attorney, 2 hours x $334 per hour) + (Compliance Manager, 8 hours x $283 per hour) = $101,932.

375 Calculated as (Senior Accountant, 250 hours x $198 per hour) + (Compliance Attorney, 4 hours x $334 per hour) + (Compliance Manager, 4 hours x $283 per hour) = $51,968. We use salary figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by SEC staff to account for a 1,800-hour work-week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

376 These figures correspond to estimates provided initially in the Cross-Border Proposing Release and updated in the Cross-Border Adopting Release. See Cross-Border Proposing Release, 78 FR 31153. See also Cross-Border Adopting Release, 79 FR 47332.

Second, registered broker-dealers (including registered SB SEFs) may incur assessment costs in connection with proposed rule 901(a)(2)(ii)(E)(4). Under the proposed rule, these entities would be required to report security-based swap transactions that they intermediate if neither side includes a U.S. person; a registered security-based swap dealer or major security-based swap participant; or a non-U.S. person that arranged, negotiated, or executed the security-based swap using its personnel, or using personnel of its agent, in a U.S. branch or office. As a result, we preliminarily believe that these entities would be required to assess the nature of transactions they intermediate.

We preliminarily believe that assessment by registered broker-dealers (including registered SB SEFs) would require an analysis of their clients (in the case of registered-broker dealers that are not registered SB SEFs) and members (in the case of registered SB SEFs). We preliminarily believe that registered broker-dealers and SB SEFs are likely to collect information about the counterparties they serve and maintain these records as part of their existing business. On the basis of these existing data, registered broker-dealers and SB SEFs would be able to determine the U.S. person status, registration status, and the location of personnel of their clients and members (or the personnel of agents of their clients and members) that submit orders.

Further, we preliminarily believe that registered broker-dealers and SB SEFs may be able to determine, on the basis of their own business models or on the basis of activity they support, whether their unregistered non-U.S. clients' and members' transactions are a result of dealing activity, and so would be able to identify which transactions of unregistered non-U.S. persons would need to be reported. For example, a registered broker-dealer that operates as an interdealer broker can likely expect that unregistered non-U.S. person clients are engaging in dealing activity.

As a result, we preliminarily believe that the assessment costs incurred by registered broker-dealer (including registered SB SEFs) are likely limited to an analysis of clients and members to identify the subset of clients and members whose trades they are obligated to report under the proposed rules, supported by systems that would record and maintain this information over time. We preliminarily believe that these costs are similar in nature to legal costs related to systems and analysis, as well as the direct costs of systems and analysis, discussed in the Cross-Border Proposing Release. We estimate that, as a result of the proposed rules imposing reporting obligations on registered broker-dealers (including SB SEFs), each of these entities would incur upfront costs of $45,304,[377] and ongoing costs of $16,612 per year.[378] We note that registered broker-dealers and SB SEFs may, like counterparties, choose alternative business structures to mitigate these costs, as discussed above. For example, they may offer transaction reporting services to their clients for a fee and report all transactions they intermediate, thus precluding the need to assess their clients' and members' activity.

Finally, we preliminarily believe that this proposed approach mitigates the concerns of some commenters regarding the costs associated with the use of the defined term "transactions conducted within the United States" as originally proposed in the Cross-Border Proposing Release.[379] In particular, by focusing on dealing activity, the proposed approach should

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377 This estimate is calculated as the sum of (Attorney at $380 per hour x 80 hours) = $30,400, and the upfront costs of systems as calculated in the Cross-Border Adopting Release. See Cross-Border Adopting Release, 79 FR 47332. We use salary figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by SEC staff to account for an 1800-hour work-week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

378 See Cross-Border Adopting Release, 79 FR 47332.

379 See, e.g., Section III.B.2(c), supra (discussing letters raising cost concerns about initially proposed approach).

eliminate the need for non-U.S. persons that do not engage in dealing activity to assess whether they or their counterparties engage in relevant activity in the United States.[380]

2. Request for comment

We request comment on all aspects of the re-proposed rule regarding its economic analysis of the application of the de minimis exception to non-U.S. persons arranging, negotiating, or executing security-based swaps using personnel located in the United States, as well as the application of external business conduct requirements for registered security-based swap dealers, associated with such transactions, including the following:

- We have preliminarily estimated assessment costs associated with determining whether transaction activity is arranged, negotiated, or executed using personnel, or the personnel of agents, located in a U.S. branch or office on a transaction-by-transaction basis, by identifying market-facing personnel involved in each transaction. Are these estimates reasonable with respect to both the use of a non-U.S. person's personnel and of its agent's personnel? Please provide data that would assist us in making more accurate estimates of these assessment costs.
- We have preliminarily suggested that some non-U.S. persons might comply with Title VII by default to reduce assessment costs. Is this suggestion reasonable? Please provide data that would assist us in making more accurate estimates of the assessment costs in these situations.
- We have preliminarily suggested that non-U.S. market participants would review business lines to determine which compliance and assessment program is optimal. Are non-U.S. market participants likely to carry out such reviews under the

380 See, e.g., note 104, supra (citing MFA/AIMA Letter).

proposed rules? Please provide data that would assist us in computing estimates of the costs of these reviews on an ongoing basis.

- Are there alternative methods that market participants may use to comply with the proposed rules other than those described above? If so, please describe the method and the costs of such method.
- Under the proposed rules, registered brokers-dealers (including registered SB SEFs) would be required to report certain transactions to a registered SDR. Please provide any additional information or data that would assist us in estimating the assessment costs such registered broker-dealers (including registered SB SEFs) may incur in determining their obligation to report.
- We have preliminarily suggested that registered broker-dealers (including registered SB SEFs) would require an analysis of their clients (in the case of registered broker-dealers) and members (in the case of registered SB SEFs), for purposes of reporting transactions pursuant to proposed rule 901(a)(2)(ii)(E)(4). We stated that we preliminarily believe that registered broker-dealers and SB SEFs are likely to collect information about the counterparties they serve and maintain these records as part of their existing business and that registered broker-dealers and SB SEFs would be able to determine the U.S.-person status, registration status, and the location of personnel of their clients and members (or the personnel of agents of their clients and members) that submit orders. Please provide comments as to whether registered broker-dealers and SB SEFs will be able to determine the U.S.-person status, registration status, and location of

personnel of their clients and members (or the personnel of agents of their clients and members) that submit orders. Please explain why or why not.

- We have stated that we preliminarily believe that registered broker-dealers and SB SEFs may be able to determine, on the basis of their own business models or on the basis of activity they support, whether their unregistered non-U.S. clients' and members' transactions are a result of dealing activity, enabling them to identify which transactions of unregistered non-U.S. persons are connected with that non-U.S. person's dealing activity and should be reported. Please provide comments as to whether registered broker-dealers and SB SEFs may be able to make this determination. Please explain why or why not.

B. Programmatic Costs and Benefits

Programmatic costs and benefits arise from applying substantive regulation to those transactions and entities that fall within the scope of the Title VII regulatory regime.[381] In the following sections, we discuss the costs and benefits of each of the Title VII requirements that the proposed rule would apply to transactions with dealing activity by personnel from a location in the United States.

1. De minimis exception

Under our proposed amendment, a non-U.S. person that, in connection with its dealing activity, enters into a transaction with another non-U.S. person would be required to include the transaction in its de minimis calculation if it arranges, negotiates, or executes the transaction using personnel located in a U.S. branch or office. This requirement would also apply to cleared anonymous transactions that are currently exempt from application of the de minimis thresholds

[381] See Intermediary Definitions Adopting Release, 77 FR 30722.

under rule 3a71-5. We are proposing rules that require the dealing counterparty to look only at the location of dealing activity of its own personnel or of its agent's personnel rather than require the dealer to look at the location of both its own activity and that of its counterparty in connection with the transaction, as was originally proposed.[382] This approach is designed to address concerns expressed by some commenters that they would, under the test proposed in the Cross-Border Proposing Release, need to track, on a trade-by-trade basis, where their counterparties are carrying out activities with respect to each transaction.[383]

Because the set of market participants that are subject to dealer regulation, including entity-level requirements under Title VII, will determine the allocation and flow of programmatic costs and benefits arising from these Title VII requirements, the inclusion of these transactions would affect the ultimate costs and benefits of our transaction-level and entity-level rules. At this time, we are unable to precisely estimate the number of potential new dealers that would be required to register because we cannot observe in the data the location of entities' dealing activity. If we assume that all security-based swap dealing activity takes place in the United States, then we currently estimate that no additional entities would be required to register as a result of this proposed rule.[384] However, we believe it is important to acknowledge the potential for additional registrants as a result of the proposed rules as the market evolves.

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382 See initially proposed Exchange Act rules 3a71-3(b)(1)(ii) and 3a71-3(a)(5); Cross-Border Proposing Release, 78 FR 30999.

383 See note 110, supra.

384 In Section VI.A.1, supra, we estimate that 15 entities would exceeded the $2 billion threshold in 2014 as a result of this rule and thus would assess their transactions to determine whether they are required to register as a dealer. Of these 15 entities, we preliminarily believe that none would exceed the $3 billion dealer de minimis threshold and thus be required to register as security-based swap dealers.

If these proposed rules regarding the de minimis exception result in an increased number of non-U.S. persons that eventually register as security-based swap dealers, a larger number of dealers would become subject to requirements applicable to registered dealers under Title VII, including, among others, capital requirements, recordkeeping requirements, and designation of a chief compliance officer. Additionally, an increase in the number of registered dealers would also mean that external business conduct requirements and Regulation SBSR also apply to larger number of transactions, as well as a larger notional volume of transactions.[385] If the proposed rules and amendments result in an increased volume of transaction activity carried out by registered security-based swap dealers, then U.S. financial markets should benefit from more consistent application of Title VII rules designed to mitigate the risk of financial contagion and enhance transparency and counterparty protections, as addressed by regulatory reporting and external business conduct requirements. Our proposed approach to determining which transactions are counted toward a non-U.S. person's de minimis threshold would also bring persons engaged in significant levels of dealing activity using personnel located in in the United States within the Title VII regulatory framework.

Furthermore, status as a security-based swap dealer brings with it specific responsibilities that are categorized as programmatic costs with respect to certain other Title VII requirements.

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[385] Under rule 901(a)(2)(ii), all transactions that include a registered security-based swap dealer on a transaction side are subject to regulatory reporting requirements. We note that our conclusion that the proposed approach will result in these requirements being applied to a larger number of transaction and notional volume of transactions requires the assumption that the demand for liquidity from security-based dealers is not very sensitive to price. Put another way, so long as market participants' demand for risk sharing opportunities provided by security-based swap transactions is relatively inelastic, any reduction in transaction volume due to the costs of Title VII regulation is unlikely to fully offset the increase in the scope of security-based swap transactions subject to Title VII regulation under the proposed rules. If, on the other hand, demand for liquidity is elastic, then the effects of higher costs may dominate any increase in the scope of external business conduct and regulatory reporting requirements, resulting in these requirements applied to a smaller number and lower notional value of transactions.

For example, Regulation SBSR places registered security-based swap dealers at the top of the reporting hierarchy for uncleared transactions.[386] Within this hierarchy, if a registered dealer transacts with an unregistered person, the registered dealer is obligated to report.[387] Thus, as a result of being classified as a dealer, a market participant that may have previously negotiated to place regulatory reporting responsibilities on its counterparties might incur the obligation to report instead.

Finally, certain elements of the Title VII regulatory regime may apply to the existing business of entities that are regulated as security-based swap dealers because they apply not only to transaction activity that cause an entity to meet the definition of a security-based swap dealer, but also to other transaction activity in which the entity participates. Entities that are required to register as security-based swap dealers under rule 3a71-3(b) incur, for example, not only the programmatic costs of external business conduct requirements for their transactions arranged, negotiated, or executed by personnel located in the United States in connection with their dealing activity, but would also be required to comply with external business conduct requirements with respect to all transactions that would be "U.S. business" under the proposed rules. As a result, they may need to develop systems or personnel, such as the designation of a chief compliance officer or the development of recordkeeping and reporting systems, for compliance purposes with respect to their U.S. business.

2. External business conduct requirements

Registered security-based swap dealers must comply with external business conduct requirements. Proposed rule 3a71-3(c) would limit application of these external business

386 See Exchange Act rule 901(a)(2)(ii)(A); Regulation SBSR Adopting Release, 80 FR 14596.

387 See Exchange Act rules 901(a)(2)(ii)(A) and 901(a)(2)(ii)(B); Regulation SBSR Adopting Release, 80 FR 14596.

conduct requirements to the U.S. business both of registered foreign security-based swap dealers and of registered U.S. security-based swap dealers, rather than applying the requirements to all transactions of such dealers.[388]

Requiring registered security-based swap dealers to comply with external business conduct requirements with respect to their U.S. business would have two major benefits. First, this requirement would apply to all transactions that constitute U.S. business, as defined under the proposed amendment, requirements that would reduce information asymmetries between security-based swap entities and their counterparties in the security-based swap market in the United States, which should reduce the incidence of fraudulent or misleading representations.[389]

Second, requiring registered foreign security-based swap dealers to comply with external business conduct requirements with respect to their U.S. business should facilitate more uniform regulatory treatment of the security-based swap activity of registered security-based swap dealers operating in the United States.[390] As we discussed above, although other business conduct frameworks (such as broker-dealer regulation) may achieve similar regulatory goals, the

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388 The proposed rules address only the scope of transactions that are subject to the external business conduct requirements; they would not change the substance of those requirements.

389 See Business Conduct Proposal, 76 FR 42452.

390 As discussed above, we recognize that, depending on the business structure that a registered U.S. or foreign security-based swap dealer employs, an intermediary (such as an agent that is a registered broker-dealer) may already be subject to certain business conduct requirements with respect to the registered security-based swap dealer's counterparty in the transaction. See Section IV.E, supra. However, as we also noted above, we think it important that the registered security-based swap dealer itself be subject to Title VII external business conduct requirements with respect to security-based swap transactions that are part of its U.S. business. See id. Because the security-based swap dealer and its agent may allocate between themselves specific responsibilities in connection with these external business conduct requirements, to the extent that these requirements overlap with requirements applicable directly to the agent (for example, in its capacity as a broker), and the dealer allocates responsibility for complying with relevant requirements to its agent, we expect any increase in costs arising from the proposed rules to be mitigated.

availability of exceptions may mean that alternative frameworks may not apply to certain business structures used by registered security-based swap dealers to carry out their business in the United States.[391] Our proposed rules would subject all registered security-based swap dealers engaged in U.S. business to the same external business conduct framework, rather than encouraging a patchwork of business conduct protections under U.S. law that may offer counterparties varying levels of protection with respect to their transactions with different registered security-based swap dealers depending on the business model (or models) that each registered security-based swap dealer has chosen to use in its U.S. business.

We recognize that adjusting the scope of transactions subject to external business conduct requirements may affect the programmatic costs incurred by participants in the security-based swap market. For entities already required to register as security-based swap dealers under current rules, the proposed rules adjust the set of transactions and counterparties to which they must apply external business conduct requirements. To the extent that the proposed rules add counterparties and their transactions to this set, registered security-based swap dealers will incur additional costs for each additional transaction.[392] However, we preliminarily believe that the approach taken in this proposal mitigates some of the commenter concerns with the originally proposed definition of "transactions conducted within the United States" by focusing only on the location of the non-U.S. dealer's market-facing personnel and the personnel of the non-U.S. dealer's agents, and not the location of its counterparties' activity.

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391 See note 202, supra (noting exception from broker-dealer definition for banks).

392 See note 275, supra (citing IIB Letter stating that the application of certain Title VII requirements, including external business conduct standards on the transactions of non-U.S. persons with foreign security-based swap dealers based on activity in the United States when neither counterparty is guaranteed would create "serious operational, legal, and economic difficulties for foreign security-based swap market participants.").

3. Regulatory reporting and public dissemination

Proposed amendments to Regulation SBSR would require certain transactions in connection with a person's dealing activity, where that person arranged, negotiated, or executed the transaction using personnel located in a U.S. branch or office, to be reported to a registered SDR and publicly disseminated. The proposed amendments would also assign reporting duties in certain transactions and further delineate limitations on reporting obligations of non-registered persons engaged in security-based swaps subject to Regulation SBSR. Additionally, the proposed amendments add provisions that would require any security-based swap transaction that is either executed on a platform having its principal place of business in the United States or effected by or through a registered broker-dealer both to be reported to a registered SDR and to be publicly disseminated pursuant to Regulation SBSR.[393]

Public dissemination of security-based swap transaction data may result in several programmatic benefits for the security-based swap market, such as improvements to liquidity and risk allocation by reducing the information asymmetries in a security-based swap market where activity is concentrated among a small number of dealers.[394] Additionally, as noted in the Regulation SBSR Adopting Release, participants in the security-based swap market with better information about the risk characteristics of their security-based swaps will be able to make more efficient investment decisions.[395] To the extent that the provision of security-based swap trade information enables participants in the security-based swap market to make privately optimal decisions, the transaction-level reporting and dissemination requirements will provide

393 See proposed rule 908(a)(1).

394 See Regulation SBSR Adopting Release, 80 FR 14704.

395 See id.

programmatic benefits in the form of improved liquidity and risk allocation.[396] We preliminarily believe that the proposed amendments would extend these effects by applying post-trade transparency to additional transactions and transaction notional.

Regulatory reporting of transaction data to registered SDRs should enable us to gain a better understanding of the security-based swap market, including the size and scope of that market. This data should enable us to identify exposure to risks undertaken by individual market participants or at various levels of aggregation, as well as credit exposures that arise between counterparties. Additionally, regulatory reporting will help the Commission in the valuation of security-based swaps. Taken together, regulatory data will enable us to conduct robust monitoring of the security-based swap market for potential risks to financial stability.

Regulatory reporting of security-based swap transactions should also improve our ability to oversee the security-based swap market and to detect and deter market abuse. We will be able, for example, to observe trading activity at the level of both trading desk and individual trader, using trading desk IDs and trader IDs, respectively. This ability to aggregate the information contained in registered SDRs using Unique Identification Codes facilitates our ability to examine for noncompliance and pursue enforcement actions as appropriate.

On the other hand, as discussed in the Regulation SBSR Adopting Release, other jurisdictions continue to develop rules related to post-trade transparency of security-based swaps at a different pace, and we are aware that the rules of these other regimes may result in increasing incentives for non-U.S. market participants to avoid contact with U.S. counterparties to avoid effecting transactions by or through registered broker-dealers in an effort to avoid public

[396] Public transaction data can improve the efficiency of private decisions but there may still remain financial network externalities as discussed in the Cross-Border Adopting Release. See Cross-Border Adopting Release, 79 FR 47284.

dissemination.[397] Responses to these incentives could reduce liquidity for U.S. market participants.[398] We cannot readily quantify the costs that might result from reduced market access for U.S. persons.[399] Moreover, we do not know definitively what rules other jurisdictions may implement or at which time they may implement their rules. In light of these limitations, we have analyzed them qualitatively, and this analysis has informed our formulation of the proposed rules and amendments contained in this release.[400]

Application of regulatory reporting requirements under the proposed amendments to rules 901 and 908 would likely impose costs on non-U.S. persons while providing benefits to the security-based swap market more generally. We preliminarily believe that the approach proposed in this release is responsive to the views of commenters.[401] Under the proposed approach, and in contrast to the original proposal based on "transactions conducted within the United States," non-U.S. persons would not be required to understand or capture whether their non-U.S.-person counterparties use personnel located in the United States, or agents with personnel located in the United States, to determine whether regulatory reporting and public

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397 See Regulation SBSR Adopting Release, 80 FR 14714.

398 See id.

399 We noted in the Regulation SBSR Adopting Release that lack of robust data and lack of experimental conditions make the costs associated with market exit or reduced liquidity that might result from post-trade transparency unquantifiable. The same limitations make the costs of reduced access to liquidity by U.S. persons as a result of public dissemination requirements under the proposed rules and amendments unquantifiable. See Regulation SBSR Adopting Release, 80 FR 14706.

400 See Section II.B.4, supra.

401 See note 275, supra (citing IIB Letter stating that the application of certain Title VII requirements, including the regulatory reporting and public dissemination requirements, on the transactions of non-U.S. persons with foreign security-based swap dealers based on activity in the United States when neither counterparty is guaranteed would create "serious operational, legal, and economic difficulties for foreign security-based swap market participants"); note 288, supra (citing Cleary Letter). See also note 289, supra (citing ISDA Letter, urging us to not apply Regulation SBSR on the basis of conduct within the United States as it would be impracticable).

dissemination requirements are applicable to transaction activity. This modified approach focuses on the location of a non-U.S. dealer's market-facing personnel in determining whether regulatory reporting requirements apply to transaction activity.

Nevertheless, we acknowledge that under the proposed rules and amendments, non-U.S. persons would bear costs of reporting insofar as they are allocated reporting responsibilities within the hierarchy laid out in proposed rule 901(a)(2)(ii)(E), and if they fall within the set of non-U.S. persons whose transactions are required to be reported under rule 908(a). Additionally, registered broker-dealers would incur reporting costs when they are involved in transactions between non-U.S. persons that do not fall within proposed rule 908(b)(5). In the Regulation SBSR Adopting Release, we estimated that 300 parties would incur costs associated with reporting transactions to registered SDRs.[402]

As noted above, we currently lack data necessary to estimate with precision the number of non-U.S. persons that, in connection with their dealing activity, arrange, negotiate, or execute security-based swaps using personnel located in the United States or execute security-based swaps on a platform with its principal place of business in the United States, or the number of registered broker-dealers that intermediate security-based swap transactions, and, as a result, cannot precisely estimate the number of additional non-U.S. persons that might incur reporting obligations under this proposal. However, assuming that all observable transaction activity is arranged, negotiated, or executed using personnel located in the United States, we estimate that 90 persons would become subject to regulatory reporting requirements under the proposed rules,

[402] See Regulation SBSR Adopting Release, 80 FR 14701.

involving approximately 2,700 transactions and $18.5 billion in notional value.[403] Additionally, we preliminarily estimate approximately 30 registered-broker dealers may be involved in effecting transactions between non-U.S. persons that would not incur any reporting duties under Regulation SBSR.

We preliminarily believe that regulatory reporting of transactions that are arranged, negotiated, or executed using personnel located in a U.S. branch or office or effected through a registered broker-dealer would have benefits for the security-based swap market. Increasing the scope of security-based swap transactions subject to regulatory reporting would likely extend the programmatic benefits of regulatory reporting discussed in the Regulation SBSR Adopting

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403 Commission staff arrived at these estimates by constructing a sample of TIW transaction records for activity between two counterparties in 2014, removing those records that involve counterparties that appear likely to register as security-based swap dealers, to isolate activity that would likely fall within the scope of proposed rule 901(a)(2)(ii)(E)(3). Staff arrived at numerical estimates by counting unique TIW accounts, transaction counts, and transaction notional represented in this sample. This revealed approximately 45 accounts and approximately 1,650 transactions, involving $8.3 billion in notional value. As in prior releases, we preliminarily believe it is appropriate to take a conservative approach and estimate an upper bound of 90 affected persons to account for growth in security-based swap participation. See Intermediary Definitions Adopting Release, 77 FR 30725 n.1457.

Further, we preliminarily believe it is reasonable to increase our estimates of transaction counts and notional volume by a factor of 1.6 to account for data limitations. First, our access to single-name CDS data is limited to activity involving one U.S. counterparty or involving CDS written on U.S. reference entities. We estimated that this limitation prevents us from observing approximately 23% of transactions. See Regulation SBSR Adopting Release, 80 FR 14689 n.1183. Second, as we note in Section II.B.1, when measured in terms of notional outstanding, the single-name CDS market accounts for approximately 80% of the overall security-based swap market. As a result, we scale up the number of observed transactions first by 1/(1-0.23) and then by 1/0.80, or to approximately 1650 x 1/0.77 x 1/0.80 = 2679 transactions, and our estimate of notional volume to approximately $8.3 billion x 1/0.77 x 1/0.80 = $13.5 billion. We acknowledge that this scaling rests on an implicit assumption that transactions we do not observe are similar in nature to the single-name CDS transaction we do observe.

Further we assume that 20% of these transactions would be reported by registered-broker dealers pursuant to 901(a)(2)(ii)(E)(4) and so no reporting of life-cycle events would be required. We use data in the Regulation SBSR Adopting Release to develop our estimate of the number of events that are not life-cycle events. See Regulation SBSR Adopting Release, 80 FR 14702.

Release by giving us a more complete view of transactions activity within the United States.[404] Moreover, in the context of market surveillance, regulatory reporting of these transactions may be particularly valuable. For example, these regulatory data would allow us to sequence all security-based swap transaction activity involving U.S. personnel. This potentially allows detection of cases in which U.S. personnel could exploit their private information about the order flow of their clients by placing proprietary orders ahead of clients' orders as an employee of a non-U.S. affiliate, avoiding regulatory reporting requirements under Regulation SBSR. Such a strategy could involve front-running orders in an opaque part of the security-based swap market at the expense of participants in a more transparent market. Monitoring for these types of activities would be more difficult in the absence of the proposed amendments to Rule 908. Finally, by requiring registered broker-dealers to report transactions in which they are involved, we preliminarily believe that our proposed approach to regulatory reporting would enable us to improve oversight of registered broker-dealers.

Regulatory reporting and public dissemination of transaction data may entail two types of costs for security-based swap market participants. First, as detailed below, requiring non-U.S. persons with dealing activity in the United States to comply with the Title VII reporting requirements even if they are not registered security-based swap dealers may entail additional costs for recordkeeping, supervision, and compliance. As some portion of these costs may be fixed, security-based swap market participants with smaller volume may be more adversely affected than larger ones. A second type of cost may fall on non-U.S. persons, including registered foreign security-based swap dealers, that wish to execute large orders or execute orders in particularly illiquid contracts. Public dissemination of these types of transactions,

[404] See Regulation SBSR Adopting Release, 80 FR 14700.

either because they involve security-based swap dealing activity in the United States or because they are effected through a registered broker-dealer, may increase the costs of hedging the inventory risk generated by such transactions because it may signal the direction of future order flow to potential counterparties to hedging transactions. As we noted in the Regulation SBSR Adopting Release, staff analysis of recent transactions in single-name CDS suggests that the impact of public dissemination on large transactions may be limited in light of the interim approach to public dissemination that allows up to a 24-hour delay before transactions data is made public.[405]

The proposed amendments to Rule 901 would assign reporting duties in certain transactions and we preliminarily believe that these duties would result in costs for U.S. and non-U.S. persons and registered broker-dealers (including registered SB SEFs) that incur a duty to report. We estimated the costs of reporting on a per-entity basis in the Regulation SBSR Adopting Release and we preliminarily believe that these proposed rules would not affect these costs. We preliminarily believe that additional persons required to report by the proposed amendments would incur costs associated with establishing internal order management systems of approximately \$102,000. These entities with reporting duties would also have to establish and maintain connectivity to a registered SDR at a cost (initial and ongoing) of approximately \$200,000. We preliminarily believe that these persons would incur costs associated with establishing a reporting mechanism for security-based swaps of approximately \$49,000. We preliminarily estimate that the ongoing costs of internal order management would be \$77,000 per year, per reporting side, and the annual and ongoing costs of storage of \$1,000 per year, per

405 See Regulation SBSR Adopting Release, 80 FR 14709. See also "Inventory risk management by dealers in the single-name credit default swap market" (October 17, 2014, available at: http://www.sec.gov/comments/s7-34-10/s73410-184.pdf).

reporting side. The Commission preliminarily believes that under the proposed amendments, entities with reporting duties would incur costs of approximately $54,000 per reporting side to establish an appropriate compliance and support program for regulatory reporting. We further estimate that such a program would require approximately $38,500 per year in annual spending by each reporting side. In aggregate, the costs of rule 901 for persons required to report under the proposed amendments in the first year would be approximately $521,500 and the annual ongoing costs would be approximately $316,500.[406] In aggregate, this suggests first-year costs of approximately $62.5 million and ongoing costs of approximately $38 million.[407]

As discussed in the Regulation SBSR Adopting Release, we preliminarily estimated and continue to believe that the burden of reporting additional transactions once a respondent's reporting infrastructure and compliance systems are in place would be minimal when compared to the costs of putting those systems in place and maintaining them over time.[408] If firms have order management systems in place and currently utilize them, the costs of reporting an additional individual transaction would be entering the required data elements into the firm's order management system, which could subsequently determine whether regulatory reporting requirements apply to the transaction, and deliver the required transaction information to a registered SDR if required.[409]

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406 See Regulation SBSR Adopting Release, 80 FR 14702.

407 First-year costs of $521,500 x 120 entities with reporting duties = $61,580,000; ongoing costs of $316,500 x 120 entities with reporting duties = $37,980,000. These costs may be mitigated to the extent that a registered broker-dealer may use the infrastructure separately established by an affiliate that already incurs reporting obligations under Regulation SBSR.

408 See Regulation SBSR Adopting Release, 80 FR 14702.

409 See id.

Besides incurring costs in connection with reporting responsibilities under rule 901, we preliminarily believe that the proposed rules would also require certain non-U.S. persons and registered broker-dealers to incur costs associated with error reporting under rule 905. As we noted in the Regulation SBSR Adopting Release, requiring participants to promptly correct erroneous transaction information should help ensure that the Commission and other relevant authorities have an accurate view of the risks in the security-based swap market. We preliminarily believe that non-U.S. persons that incur reporting obligations under the proposed amendments would incur an initial cost of $11,825 per reporting side and an ongoing cost of $4,000 per reporting side.[410]

These figures suggest aggregate initial costs of $1,419,000 and ongoing costs of $480,000.[411] As with rule 901, as adopted, we do not believe that the additional amendments made to rule 901 in this release would have any measurable impact on the costs previously discussed in both the Regulation SBSR Proposing Release and the Cross-Border Proposing Release.[412]

We preliminarily believe that, in addition, the 540 additional transactions effected by or through registered broker-dealers may impose costs on participants that are associated with notifying registered broker-dealers after discovery of an error as required under rule 905(a)(1).

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410 See id. at 14778. Note that we preliminarily believe that this proposal does not alter the number of participants that are not reporting sides who, under rule 905(a)(1), are required to notify the relevant reporting side after discovery of an error.

411 Initial costs of $11,825 x 120 entities with reporting duties = $1,419,000; ongoing costs of $4,000 x 120 entities with reporting duties = $480,000.

412 See Regulation SBSR Adopting Release, 80 FR 14702. See also Regulation SBSR Proposing Release, 75 FR 75261; Cross-Border Proposing Release, 78 FR 31192.

We preliminarily estimate an annual cost associated with this obligation of approximately $17,280, which corresponds to roughly $576 per participant.[413]

Finally, the proposed amendments to rule 906 may impose costs on registered broker-dealers that must report transactions to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4). Under proposed amendments to rule 906(c), these registered broker-dealers would be required to establish, maintain, and enforce policies and procedures that are reasonably designed to ensure that it complies with any obligations to report information to a registered SDR in a manner consistent with Regulation SBSR. Further, these registered broker-dealers would be required to review these policies and procedures at least annually. We preliminarily estimate that the cost associated with establishing such policies and procedures would be approximately $58,000 and the cost associated with annual updates would be approximately $34,000, for each registered broker-dealer that incurs an obligation to report transactions under our proposed approach.[414]

4. Efficiency, competition, and capital formation

Our analysis of the proposed rules' potential impacts on efficiency, competition, and capital formation begins by considering the effects the proposed rules may have on the scope of participants subject to dealer requirements under Title VII. Following this discussion, we

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413 These figures are based on the assumption that approximately 540 additional trades per year would have to be reported by registered broker-dealers pursuant to proposed rule 901(a)(2)(ii)(E)(4) and that these trades involve 30 entities with reporting duties. Using cost estimated provided in the Regulation SBSR Adopting Release, if each trade is reported in error, then the aggregate annual cost of error notification is 540 errors x Compliance Clerk at $64 per hour x 0.5 hours per report = $17,280, or $576 per participant. See Regulation SBSR Adopting Release, 80 FR 14714. We use salary figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by SEC staff to account for a 1800-hour work-week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

414 See Regulation SBSR Adopting Release, 80 FR 14716.

examine potential effects of the proposed rules related to their effect on the application of Regulation SBSR.

We note that the proposed rules and amendments would, if adopted, affect the security-based swap market in a number of ways, many of which are difficult to quantify, if not unquantifiable. In particular, a number of the potential effects that we discuss below are related to price efficiency, liquidity and risk sharing. These effects are difficult to quantify for a number of reasons. First, in many cases the effects are contingent upon strategic responses of market participants. For instance, we note in Section VI.B.4(b)i, infra, that, under our proposed approach, non-U.S. persons may choose to relocate personnel making it difficult for U.S. counterparties to access liquidity in security-based swaps. The magnitude of these effects on liquidity and on risk sharing depend upon a number of factors that we cannot estimate, including the likelihood of relocation, the availability of substitute liquidity suppliers and the availability of substitute hedging assets. Therefore, much of the discussion below is qualitative in nature, although we try to describe, where possible, the direction of these effects.

Not only can some of these effects be difficult to quantify, but there are many cases where a rule will have two opposing effects, making it difficult to estimate a net impact on efficiency, competition, or capital formation. For example, in our discussion of the net effect of the proposed application of Regulation SBSR requirements on efficiency, we expect that post-trade transparency may have a positive effect on price efficiency, while it may negatively affect liquidity by providing incentives for non-U.S. persons to avoid contact with U.S. persons. The magnitude of these two opposing effects will depend on factors such as the sensitivity of traders to information about order flow, the impact of public dissemination of transaction information on the execution costs of large orders, and the ease with which non-U.S. persons can find substitutes that avoid contact with U.S. personnel. Each of these factors is difficult to quantify individually, which makes the net impact on efficiency equally difficult to quantify.

(a) De minimis calculations

The proposed rules and amendments related to the treatment of transactions arranged, negotiated, or executed by personnel located in the United States for the purposes of de minimis calculations likely broadens the scope of security-based swap transactions and entities to which the Title VII regulatory regime for security-based swap dealers applies. As a result, the proposal may increase the effects on efficiency, competition, and capital formation of rules already adopted as well as of future substantive rulemakings that place responsibilities on registered security-based swap dealers to carry out entity- or transaction-level requirements applicable to security-based swap dealers under Title VII.[415]

The proposed rules and amendments may directly affect efficiency, competition, and capital formation because the requirement that non-U.S. persons include in their de minimis threshold calculations security-based swaps in connection with their dealing activity that they arrange, negotiate, or execute using personnel located in a U.S. branch or office may increase the likelihood that certain non-U.S. dealers would exceed de minimis levels of dealing activity and be required to register with the Commission. Registration would cause these dealers to incur registration costs as well as the costs of dealer requirements under the Title VII regulatory regime.

These costs may represent barriers to entry for non-U.S. persons that contemplate engaging in dealing activity using their own personnel or personnel of their agents located in a U.S. branch or office or provide incentives for non-U.S. persons that currently engage in relevant

[415] See Cross-Border Adopting Release, 79 FR 47361.

activity using personnel located in a U.S. branch or office to restructure their business and move operations abroad or use agents with personnel outside of the U.S.[416] These costs may additionally provide direct incentives for non-U.S. persons to avoid using personnel of agents located in a U.S. branch or office (or agents with such personnel) to arrange, negotiate or execute security-based swaps on their behalf. By reducing the ability of these agents to compete for business from non-U.S. persons, the proposed rules may reduce entry by potential agents because of this competitive disadvantage, or cause existing agents to relocate or restructure their business to minimize contact with the United States.[417]

We acknowledge that, to the extent that it occurs solely for the purposes of avoiding Title VII regulation, reduced market entry or restructuring by non-U.S. persons responding to our proposed approach, or by agents unable to compete for business from non-U.S. persons, may be inefficient, raise costs to market participants and reduce the level of participation by personnel of non-U.S. persons located in the United States, or personnel of their agents located in the United States.[418] Our proposed approach reflects consideration of the potentially inefficient restructuring and reduced access to the security-based swap market by U.S. persons on the one hand, and addressing the concerns of Title VII on the other. In particular, this proposed approach potentially reduces the risk of financial contagion and fraudulent or manipulative conduct by ensuring that security-based swap dealer regulation is applied to the appropriate set of entities whose activities raise these concerns.

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416 See id. at 47362.

417 We also note that, under the proposed rules, non-U.S. persons may be willing to pay higher prices for higher quality services provided by non-U.S.-person counterparties that use personnel or agents located in the United States because the ability of these counterparties to meet the standards set by Title VII may be a credible signal of high quality. See id. at 47362 n.762.

418 See id. at 47364.

We also preliminarily believe that the proposed rules and amendments would affect competition among security-based swap dealers. Under proposed Exchange Act rule 3a71-3(b)(iii)(C), U.S. persons would have to count their dealing activity towards their de minimis thresholds while their non-U.S. competitors would not. As noted in Section II.A, supra, in the absence of the proposal, a U.S. person engaged in dealing activity and facing a non-U.S.-person counterparty or its agent would face different regulatory treatment from a non-U.S. person engaged in the same activity with the same counterparty or its agent, even if both are arranging, negotiating, or executing the security-based swap using personnel located in a U.S. branch or office. As a result, and as noted by commenters,[419] current rules may introduce different costs for U.S. security-based swap dealers and foreign security-based swap dealers and their agents that seek to supply liquidity to non-U.S. persons as a result of Title VII regulation, introducing competitive disparities even if the U.S. person and the non-U.S. person or their agents are both, in connection with their dealing activity, using personnel located in the United States. Under the current rules, non-U.S. persons seeking or supplying liquidity may also be reluctant to transact with a U.S. person because of the additional expected costs of dealer regulation and of future substantive regulations under Title VII that rest on the U.S.-person status of counterparties. We preliminarily believe that many of the costs of these frictions would be borne by U.S. security-based swap dealers. The proposed rules and amendments may mitigate these competitive frictions because non-U.S. persons would be required to count transactions arranged, negotiated,

[419] See note 196, supra (citing IIB Letter and SIFMA/FIA/FSR Letter raising concerns that the proposed rule could put U.S. brokers and investment managers at a competitive disadvantage). See also note 138, supra (citing AFR Letter to CFTC); notes 139 and 299, supra (citing CDEU Letter to CFTC); note 131, supra (citing ISDA Letter to CFTC and SIFMA/FIA/FSR Letter to CFTC); note 142, supra (citing Société Générale Letter to CFTC); note 143, supra (citing JFMC Letter to CFTC, CDEU Letter to CFTC, SIFMA/FIA/FSR Letter to CFTC, and IAA Letter to CFTC); note 300, supra (citing ISDA Letter to CFTC). See also note 101, supra.

or executed by personnel located in a U.S. branch or office towards their de minimis thresholds in a way that is identical to their U.S.-person competitors.[420]

As with the proposed amendment that would require non-U.S. persons to count transactions arranged, negotiated, or executed by personnel located in a U.S. branch or office towards de minimis thresholds, the proposal does not retain an exception for cleared, anonymous transactions and thus should reduce the competitive frictions that would exist if the proposal retained the exception. Such an exception would provide non-U.S.-person dealers that arrange, negotiate, or execute cleared, anonymous transactions using personnel located in a U.S. branch or office or using agents with personnel in a U.S. branch or office a potential competitive advantage relative to U.S. persons, as the non-U.S. persons would be able to avoid including these transactions in their de minimis calculations, while U.S. persons would be required to count all such transactions towards their de minimis thresholds. However, we also note that, to the extent that non-U.S. persons otherwise would have relied upon this exception to engage in cleared, anonymous transactions, our proposed approach may impair efficiency and capital formation by reducing liquidity in anonymous markets, increasing transaction costs, and reducing opportunities for risk-sharing among security-based swap market participants.[421]

Alternatively, the proposed rule may result in inefficient restructuring to move the arrangement, negotiation, and execution of cleared, anonymous transactions abroad, in order to avoid activities that would require counting towards de minimis thresholds. This may have adverse consequences for the availability of liquidity and the amount of transaction costs for U.S. persons seeking to hedge risk using security-based swaps. If non-U.S. persons relocate their

420 See Cross-Border Proposing Release, 78 FR 31127; Cross-Border Adopting Release, 79 FR 39152.

421 See Cross-Border Adopting Release, 79 FR 47363.

dealing activity abroad in ways that make it difficult for U.S. persons to find liquidity in the United States, those U.S. persons that might otherwise use security-based swaps to hedge financial and commercial risks may reduce their hedging activity and assume an inefficient amount of risk, or engage in precautionary savings that inhibits capital formation.[422] To the extent that non-U.S. persons use U.S. personnel to engage in dealing activity only in a subset of security-based swaps, such as those involving certain reference entities, we preliminarily believe that the potential consequences of relocation on liquidity and risk sharing would be most concentrated in this subset.

(b) Other Title VII requirements

The proposed rules regarding the regulatory reporting, public dissemination and external business conduct requirements for transactions arranged, negotiated, or executed by personnel located in a U.S. branch or office would have several effects on efficiency, competition, and capital formation in the U.S. financial market. These effects implicate common economic themes and warrant a consolidated discussion.

i. Efficiency

The application of public dissemination as set forth in the proposed rule may improve the efficiency of the price discovery process and improve the liquidity of traded security-based swaps. Market participants with more information about the history of prices due to enhanced post-trade transparency will be better able to price security-based swaps, and as a result make better trading decisions. Market observers will be able to incorporate information from the security-based swap market to derive valuations for other assets that are more accurate.[423]

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422 See note 143, supra (citing CDEU Letter to CFTC).

423 See Regulation SBSR Adopting Release, 80 FR 14720.

We preliminarily believe that the magnitude of these efficiency improvements is related to the number of transactions subject to public dissemination. Data from more transactions may allow market participants and observers to derive more precise estimates of fundamental value. As a result, to the extent that the proposed rules increase the scope of security-based swap transactions subject to public dissemination, they may result in more efficient pricing and valuation within and without the security-based swap market.[424]

At the same time, we recognize that particular Title VII requirements may affect efficiency through their effects on the ability of security-based swap market participants to access liquidity. We preliminarily believe that certain aspects of our proposal should reduce the likelihood of market fragmentation. For example, the proposed rules and amendments, by reducing the likelihood that transactions arranged, negotiated, or executed within the United States are subject to disparate levels of regulation under Title VII depending on counterparty identity, the proposed rules may allow U.S. persons to more freely access liquidity made available through dealing activity within the United States and may discourage the formation of a two-tier market in which U.S. persons and non-U.S. persons are offered liquidity on very different terms.

However, we also acknowledge that the proposed rules may provide incentives for non-U.S. persons to move their operations and personnel abroad to avoid external business conduct, regulatory reporting, and public dissemination requirements. If, under the proposed rules, non-

424 See Gjergji Cici, Scott Gibson, and John J. Merrick, Jr., "Missing the Marks? Dispersion in Corporate Bond Valuations Across Mutual Funds," Journal of Financial Economics, Volume 101, Issue 1 (July 2011), at 206-26 (providing evidence that the implementation of post-trade transparency in the corporate bond market could have contributed to a reduction in the dispersion of mutual fund valuations during the study's sample period). See also 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%).

U.S. security-based swap market participants relocate their sales forces and trading desks to other jurisdictions, less liquidity may be available within the United States, reducing the efficiency of prices and risk sharing. U.S. counterparties may find it difficult to take desired positions in security-based swaps if their access to non-U.S. liquidity providers is limited or more costly. For example, if U.S. persons seeking to hedge risk using security-based swaps have difficulty obtaining liquidity solely from U.S. providers, they may reduce their hedging activity in the security-based swap market, seek substitutes in other asset markets, or assume an inefficient amount of risk.[425] We note that the incentive to relocate personnel may grow to the extent that there is a substantial disparity in regulatory requirements applicable to those transactions that are arranged, negotiated, or executed by personnel from a location within the United States and those transactions that are not.

As an alternative to relocating personnel, we acknowledge that participants may implement or adapt existing controls or conventions that restrict communication between non-U.S. trading personnel and persons located in the United States to avoid triggering certain Title VII requirements. For example, firms may adopt policies restricting personnel located outside the United States from communicating with personnel located in the United States when engaging in dealing activity with non-U.S.-person counterparties. Non-U.S. firms might additionally restrict personnel located in the United States from arranging, negotiating, or executing security-based swaps in connection with the non-U.S. firm's dealing activity with non-U.S.-person counterparties.

Although non-U.S. persons may voluntarily impose internal conventions and controls on their own personnel to avoid triggering certain Title VII requirements, these conventions and

[425] See note 143, supra (citing CDEU Letter to CFTC).

controls may result in inefficient duplication of personnel or expertise in foreign and U.S. locations. Non-U.S. persons may choose to impose controls on personnel if the costs of duplication are below the costs of applying Title VII to relevant activity,[426] but we preliminarily believe that such a strategic choice may not take into account the programmatic benefits of Title VII regulation. For example, public dissemination requirements under Title VII improve the transparency of the security-based swap market while causing market participants and SDRs to incur costs. Other portions of the Title VII regulatory framework, such as capital and margin requirements yield programmatic benefits by reducing the risk of sequential counterparty default, but security-based swap dealers may consider the impact of such requirements on their own costs, without considering impacts on aggregate financial sector risk.[427] Thus, although internal personnel controls may be privately optimal for firms that choose to implement them, their net impact on efficiency will depend on how the costs of personnel duplication compare to the overall costs and benefits of the Title VII dealer regulation, external business conduct, regulatory reporting, and public dissemination requirements.

Similarly, we preliminarily believe that our proposed approach more consistently applies

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426 See Section VI.A (discussing the estimated per-entity costs of these controls).

427 See e.g. 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 (showing the emergence of financial network externalities in a theoretical model of banks, in which banks may take into account the effect of their own risk taking on their creditors, but may fail to internalize the effects of their own risk taking on their creditors' creditors).

See also 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. (using 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.

regulatory reporting and public dissemination requirements to transactions effected by or through trading platforms and registered broker-dealers, including registered SB SEFs. Both trading platforms and registered broker-dealers may intermediate transactions in the security-based swap market. By ensuring that both types of intermediation are subject to regulatory reporting and public dissemination requirements, the proposed approach reduces the risk that, as a result of disparate treatment, liquidity migrates from trading platforms to registered broker-dealers or from registered broker-dealers to trading platforms. However, at the same time, we acknowledge the risk that, in response to the proposed rules and amendments, trading platforms may choose to move their principal place of business offshore and registered broker-dealers may move their security-based swap businesses into unregistered entities to avoid regulatory reporting requirements.

Attempts to restructure by counterparties, trading platforms and registered broker-dealers could have an adverse effect on the efficiency of the security-based swap market by fragmenting liquidity between a U.S. security-based swap market, occupied by U.S. persons and non-U.S. persons willing to participate within the Title VII regulatory framework, with intermediation services provided by registered broker-dealers and U.S.-based trading platforms, and an offshore market whose participants seek to avoid any activity that could trigger application of Title VII to their security-based swap activity.[428] Such market fragmentation could reduce the amount of liquidity available to market participants whose activity is regulated by Title VII and significantly erode any gains in price efficiency and allocative efficiency that might result from pre- and post-trade transparency.

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428 See Cross-Border Adopting Release, 79 FR 47364.

ii. Competition

We preliminarily believe that our proposed approach would have implications for competition among market participants that intermediate transactions in security-based swaps as well as counterparties to security-based swaps. First, the proposed rules and amendments to rules 901 and 908 would apply consistent regulatory reporting and public dissemination requirements to transactions between non-U.S. persons that are platform-executed or effected through registered broker-dealers. We preliminarily believe that our proposed application of regulatory requirements is unlikely to generate competitive frictions between these different types of providers of intermediation services. At the same time, we acknowledge that proposed rule 908(a)(1)(iv) may make it difficult for suppliers of intermediation services (i.e., trading platforms and broker-dealers) effecting or executing transactions within the United States, to compete to serve non-U.S. persons. Nonetheless, we preliminarily believe that our proposed approach would appropriately reflect the transparency focus of Title VII and would promote a robust regulatory regime for registered broker-dealers.

Applying external business conduct requirements and Regulation SBSR to transactions in connection with a non-U.S. person's dealing activity that the non-U.S. person arranges, negotiates, or executes using personnel located in the United States would mitigate competitive frictions between U.S. and non-U.S. persons[429] by providing for a generally consistent application of these requirements to U.S.-person dealers and non-U.S.-person dealers or their agents to the extent that the latter arrange, negotiate, or execute a security-based swap transaction

[429] Competitive effects would flow from each of the relevant Title VII requirements. For instance, post-trade transparency may increase competition between dealers by reducing the level of private information that large dealers have relative to smaller dealers and by improving the ability of non-dealers to negotiate with dealers on prices. See Regulation SBSR Adopting Release, 80 FR 14704.

in connection with their dealing activity using personnel located in a U.S. branch or office.[430] If only U.S. dealers and their agents were subject to disclosure requirements with respect to their security-based swap transactions, the costs of such disclosures would primarily affect U.S. dealers, their agents, and their counterparties. In contrast, non-U.S. dealers and their agents, who may not necessarily be subject to comparable disclosure requirements, could have a competitive advantage over U.S. dealers in serving non-U.S.-person counterparties using personnel located in a U.S. branch or office, were their activities not subject to the same requirements.[431] Furthermore, we preliminarily believe the ability to meet certain Title VII regulatory requirements under the proposed rules may allow non-U.S. persons who use personnel or personnel of agents located in the United States to engage in dealing activity to credibly signal high quality and better counterparty protection relative to other non-U.S. persons that compete for the same order flow from weaker regulatory environments.[432] Non-U.S. persons that choose to use personnel or personnel of agents for dealing activity from a location within the United States may find fraud or abusive behavior more costly and difficult to conduct, which may signal to other non-U.S. persons that such fraud or abusive behavior is unlikely to occur.

We are not proposing, however, to apply the clearing and trade execution requirements to security-based swap transactions that a non-U.S. person, in connection with its dealing activity, arranges, negotiates, or executes using personnel located in a U.S. branch or office. This aspect

430 See Cross-Border Proposing Release, 78 FR 31127; Cross-Border Adopting Release, 79 FR 47327 (providing earlier discussions of these issues).

431 See, e.g., Arnoud W.A. Boot, Silva Dezelan, and Todd T. Milbourn, "Regulatory Distortions in a Competitive Financial Services Industry," Journal of Financial Services Research, Vol. 17, No. 1 (2000) (showing that, in a simple industrial organization model of bank lending, a change in the cost of capital resulting from regulation results in a greater loss of profits when regulated banks face competition from unregulated banks than when regulations apply equally to all competitors).

432 See Cross-Border Adopting Release, 77 FR 47362 n.762.

of our proposal may contribute to a disparity in the regulatory treatment of U.S. persons and non-U.S. persons in the security-based swap market, as non-U.S. persons that engage in dealing activity using personnel located in the United States would only be subject to Title VII dealer regulation and Regulation SBSR, while U.S. persons would also be required to comply with the clearing and trade execution requirements. If clearing and trade execution requirements comprise a large portion of the Title VII compliance costs, then a competitive disparity between U.S. and non-U.S. participants in the security-based swap market may remain, even with the addition of the proposed rules. However, to the extent that U.S. persons and non-U.S. persons whose obligations under a security-based swap are guaranteed by U.S. persons must increase the price of the liquidity they supply in response to this disparity in regulatory treatment, we preliminarily believe that these higher prices reflect an efficient allocation of the costs their activity may impose on the U.S. financial system, given that the counterparty credit risk of such security-based swap transactions resides primarily in the United States.

iii. Capital Formation

The proposed rules may affect capital formation in the security-based swap and securities market by affecting the transparency, liquidity, and stability of the market. Requiring transactions by non-U.S. persons, in connection with their dealing activity, with relevant activity in the United States to be reported and publicly disseminated should facilitate monitoring of the security-based swap market and improve the price discovery process and the liquidity of security-based swaps.[433] These improvements may lead to more efficient allocation of capital by market participants and market observers, facilitating capital formation.

433 See Regulation SBSR Adopting Release, 80 FR 14719-722.

We recognize that the effects of the proposed rule on market fragmentation may affect capital formation. If the proposed rules reduce the likelihood of fragmentation of the security-based swap market, then they may promote capital formation. Under a regulatory environment that facilitates U.S. persons' access to the global security-based swap market, U.S. market participants will be able to more efficiently hedge financial and commercial risks, reducing the level of precautionary savings they choose to hold and instead investing resources in more productive assets. However, if the proposed rules cause non-U.S. persons to move personnel and operations abroad or use agents operating outside the United States, the costs of the move represent resources that could have been invested in productive assets. Furthermore, to the extent that such restructuring results in a fragmented market with reduced liquidity for security-based swaps and related assets within the United States, the result could be less risk sharing and impaired capital formation.[434]

5. Request for comment

The Commission requests comment on all aspects of our discussion and analysis concerning programmatic costs and benefits, and potential impacts, of the proposed rule on efficiency, competition, and capital formation, including the following:

- Does our discussion above accurately characterize, qualitatively and quantitatively, the incentives for entities to restructure in the absence of, or as a result of, the proposed rules? Please explain and provide information that would be helpful in performing further analysis.
- Does our discussion above accurately characterize, qualitatively and quantitatively, the benefits and costs of application of external business conduct

[434] See Cross-Border Adopting Release, 79 FR 47365.

requirements to transactions with dealing activity by personnel from a location within the United States? Please explain and provide information that would be helpful in performing further analysis.

- Our proposal does not retain an exception for cleared, anonymous transactions that would exclude these from the de minimis calculations for non-U.S. persons. Please provide information that would be helpful in estimating any effects of this approach on liquidity on platforms that support anonymous trading.
- Does our discussion above accurately characterize, qualitatively and quantitatively, the benefits and costs of application of Title VII requirements to transactions between two non-U.S. persons in which at least one of the non-U.S. persons, in connection with its security-based swap dealer activity, arranges, negotiates, or executes the security-based swap using personnel located in the United States? Please explain and provide information that would be helpful in performing further analysis.

C. Alternatives Considered

In developing these proposed rules and amendments we considered a number of alternative approaches. This section outlines these alternatives and discusses the potential economic effects of each.

1. Retention of the definition of "transaction conducted within the United States"

In the Cross-Border Proposing Release, we originally proposed the definition "transaction conducted within the United States" and used it to identify (i) transactions that should be included in an entity's de minimis threshold calculations, and (ii) transactions that, subject to certain exceptions, would be subject to the set of Title VII requirements for business conduct, clearing, trade execution, regulatory reporting, and public dissemination. The original objective of the initial definition was identical to this proposed rule—to capture relevant dealing activity within the United States in order to mitigate competitive frictions and prevent a non-U.S. person from shifting its security-based swap dealing activity to a non-U.S. person and continue to carry out this dealing activity in the United States while avoiding application of the Title VII requirements by using personnel of the non-U.S. person located in the United States or personnel of its agent located in the United States.

We have determined to propose a different approach in part because we preliminarily agree with commenters that the initial approach likely would have increased assessment costs significantly.[435] That initial approach would have looked to whether dealing activity involved a "transaction conducted within the United States," which, as defined in that proposal, turned on the location of personnel on both sides of the transaction. Accordingly, under the rule as initially proposed, an entity would have been required to include a transaction in its de minimis threshold calculations based on the location of its counterparty's personnel. Gathering such information, communicating it to relevant counterparties, and keeping records of this information on a per-transaction basis could be costly. We preliminarily believe that our re-proposed approach, which focuses only on whether the non-U.S. person is arranging, negotiating, or executing a security-based swap, in connection with its dealing activity, using personnel located in a U.S. branch or office, achieves many of the same programmatic benefits, while resulting in in lower assessment costs.[436]

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435 See, e.g., note 289, supra (citing ISDA Letter).

436 As we noted in Section III.B.2, supra, some commenters urged that an activity-based test should look only to where the relevant transaction was executed or where the dealer's personnel committed the dealer to that trade. Although we acknowledge that such an alternative may result

2. Limited exception from Title VII requirements for transactions arranged, negotiated, and executed by associated persons of broker-dealers

We also considered not requiring a non-U.S. person to include a transaction in its de minimis threshold calculations if the security-based swap dealing activity was arranged, negotiated, or executed in the United States solely by personnel of a registered broker-dealer that were acting in their capacity as associated persons of that broker-dealer. One commenter suggested such an approach.[437] Although this approach could reduce costs associated with engaging in customer-facing activity in connection with dealing activity in security-based swaps in the United States, it would, as described in more detail above,[438] create potentially significant compliance gaps in our Title VII framework, potentially impeding our effective enforcement of Title VII and other federal securities laws by reducing the number of transactions carried out by registered security-based swap dealers and thus limiting our access to the books and records that are necessary for effective enforcement.

3. Exclusion of security-based swap transactions that do not involve a U.S.-person counterparty, a counterparty whose obligations under the security-based swap are guaranteed by a U.S. person, or a conduit affiliate from the de minimis threshold requirements

Although the Cross-Border Adopting Release stated that we contemplated considering whether to subject certain security-based swap transactions involving activity in the United States to certain Title VII requirements, one alternative to the proposed rules would be not to require any transactions other than those required in rule 3a71-3 to be counted toward a person's

in costs that are meaningfully lower than the costs of our proposed approach, because we do not believe that such an alternative would adequately capture the range of market-facing activities that appear likely to raise the types of concerns addressed by security-based swap dealer regulation, we do not believe that this approach reflects a reasonable alternative to the proposed approach.

437 See note 197, supra (citing IIB Letter).

438 See Section III.B.5(c), supra.

dealer de minimis threshold. However, in our preliminary view, in the absence of some form of activity-based test, the current scope of rules may not adequately address fraud and competitive fragmentation concerns. Further, personnel located in a U.S. branch or office may be employed by both U.S. and non-U.S. persons. Absent an activity-based test, our ability to enforce relevant regulations may be hindered by our inability to monitor the activity of such personnel carried out in their role as employee of the non-U.S. person.

The absence of an activity-based test may also adversely affect competition between U.S. and non-U.S. persons. Under current rules, the disparity in regulatory treatment means U.S. and non-U.S. persons will face disparate regulatory costs even if both engage in dealing activity using personnel located in a U.S. office. Non-U.S. persons or their agents transacting with other non-U.S. persons or their agents in the United States would potentially be able to provide liquidity at lower cost than U.S. persons because of differing regulatory treatment in other jurisdictions. As a result, non-U.S. persons could prefer to transact with non-U.S. persons or their agents, and a substantial portion of liquidity from non-U.S. persons may become unavailable to U.S. persons.

4. Extension of the activity-based test to the clearing and execution requirements

As we discuss above in Section V.D, we are not proposing to require mandatory clearing or mandatory trade execution for security-based swap transactions that are arranged, negotiated, or executed using personnel located in a U.S. branch or office.[439] Under this alternative, we would subject all transactions arranged, negotiated, or executed by personnel located in a U.S. branch or office to the clearing and trade execution requirements. Non-U.S. entities that are

[439] Because we have not yet issued any clearing determinations, no security-based swaps are currently subject to mandatory clearing. See Section II.B.3, supra.

required to determine whether a transaction must be included in their dealer de minimis threshold calculations, or whether they are subject to the external business conduct rules or Regulation SBSR would be able to use the same assessment in determining whether such a transaction would be subject to the clearing and trade execution requirements. Further, transactions that were arranged, negotiated, or executed by non-U.S. persons using personnel located in a U.S. branch or office would be subject to clearing and trade execution requirements identical to those faced by U.S. persons and counterparties to U.S. persons. Such consistency in regulatory treatment could reduce competitive disparities between U.S. persons and non-U.S. persons that operate in the United States. This alternative may reduce the likelihood that a two-tier security-based swap market emerges as a result of differences in regulatory requirements across jurisdictions.

However, we preliminarily believe that this policy choice would adversely affect efficiency and increase the risk of market fragmentation. We preliminarily believe that imposing the clearing and execution requirements may impose unnecessary costs on certain non-U.S. market participants in relation to the risks posed by their activity to the United States. For example, these requirements may require non-U.S. persons and their agents to form new relationships with clearing agencies and trading platforms in the United States. Given that the risk to the U.S. financial system in the security-based swap transactions at issue in this release resides with non-U.S. persons with no recourse guarantee against U.S. persons, we preliminarily believe that any potential risk posed to the U.S. financial system does not warrant imposing clearing and trade execution requirements on these security-based swap transactions. In particular, we preliminarily believe that the margin requirements for foreign security-based swap dealers, which we have proposed to apply on an entity-level basis, would be sufficient to address the risk to the U.S. from non-U.S. persons with no recourse guarantee against U.S. persons and that the costs of the margin requirement would be commensurate to the risks involved.

VII. Paperwork Reduction Act

A. Introduction

Certain provisions of our proposal contain "collection of information"[440] requirements within the meaning of the Paperwork Reduction Act of 1955 ("PRA") and we are submitting the proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

We are proposing amendments to previously adopted Regulation SBSR, which contained 12 collections of information.[441] The proposed amendments amend the "reporting hierarchy" adopted in Regulation SBSR that specifies the side that has the duty to report a security-based swap that is a "covered transaction"[442] and provides for public dissemination of security-based swap transaction information (except as provided in rule 902(c)) for certain transactions.[443] As provided in the Regulation SBSR Adopting Release, registered SDRs are required to establish and maintain certain policies and procedures regarding how transaction data are reported and

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440 44 U.S.C. 3502(3).

441 See SBSR Adopting Release, 80 FR 14673.

442 See Regulation SBSR Adopting Release, 14567, (describing "covered transaction" as "all security-based swaps except: (1) clearing transactions; (2) security-based swaps that are executed on a platform and that will be submitted to clearing; (3) transactions where there is no U.S. person, registered security-based swap dealer, or registered major security-based swap participant on either side; and (4) transactions where there is no registered security-based swap dealer or registered major security-based swap participant on either side and there is a U.S. person on only one side").

443 See proposed rules 908(a)(1)(iii), (iv) and (v).

disseminated, and participants of registered SDRs that are registered security-based swap dealers or registered major security-based swap participants are required to establish and maintain policies and procedures that are reasonably designed to ensure that they comply with applicable reporting obligations.

The hours and costs associated with complying with Regulation SBSR constitute reporting and cost burdens imposed by each collection of information. We preliminarily believe that the methodology used for calculating the paperwork burdens set forth in the Regulation SBSR Adopting Release is appropriate for calculating the paperwork burdens associated with the amendments proposed here.

The proposed amendments containing these specific collections of information are discussed further below.

B. Reporting Obligations—Rule 901

Rule 901 sets forth various requirements relating to the reporting of covered transactions. The title of this collection is "Rule 901—Reporting Obligations."

1. Summary of collection of information

Title VII of the Dodd-Frank Act amended the Exchange Act to require the reporting of security-based swap transactions. Accordingly, we adopted rule 901 of Regulation SBSR under the Exchange Act to implement this requirement. Rule 901 specifies, with respect to each reportable event pertaining to covered transactions, who is required to report, what data must be reported, when it must be reported, where it must be reported, and how it must be reported. Rule 901(a), as adopted, established a "reporting hierarchy" that specifies the side that has the duty to report a security-based swap that is a covered transaction.[444] The reporting side, as determined

[444] See Regulation SBSR Adopting Release, 80 FR 14674 (citing notes 11-12).

by the reporting hierarchy, is required to submit the information required by Regulation SBSR to a registered SDR. The reporting side may select the registered SDR to which it makes the required report. Pursuant to rule 901(b), as adopted, if there is no registered SDR that will accept the report required by rule 901(a), the person required to make the report must report the transaction to the Commission. Rule 901(c) sets forth the primary trade information and rule 901(d) sets forth the secondary trade information that must be reported. Under the final rules, covered transactions—regardless of their notional amount—must be reported to a registered SDR at any point up to 24 hours after the time of execution, or, in the case of a security-based swap that is subject to regulatory reporting and public dissemination solely by operation of rule 908(a)(1)(ii), within 24 hours after the time of acceptance for clearing.[445] Except as required by rule 902(c), the information reported pursuant to rule 901(c) must be publicly disseminated. Information reported pursuant to rule 901(d) is for regulatory purposes only and will not be publicly disseminated.

Rule 901(e) requires the reporting of life cycle events, and adjustments due to life cycle events, within 24 hours of the time of occurrence, to the entity to which the original transaction was reported. Reports of life cycle events must contain the transaction ID of the original transaction.

In addition to assigning reporting duties, rule 901 also imposes certain duties on a registered SDR that receives security-based swap transaction data. Rule 901(f) requires a

445 See Regulation SBSR Adopting Release, Section VII(B)(1) (discussing rule 901(j) and the rationale for 24-hour reporting timeframe). Rule 901(j) provides that, if 24 hours after the time of execution would fall on a non-business day (i.e., a Saturday, Sunday, or U.S. federal holiday), reporting is required by the same time on the next business day. Rule 908(a)(1)(ii), as adopted, provides that a security-based swap that is subject to regulatory reporting and public dissemination solely by operation of rule 908(a)(1)(ii)—i.e., because the security-based swap has been accepted for clearing by a clearing agency having its principal place of business in the United States—must be reported within 24 hours of acceptance for clearing.

registered SDR to timestamp, to the second, any information submitted to it pursuant to rule 901, and rule 901(g) requires a registered SDR to assign a transaction ID to each security-based swap, or establish or endorse a methodology for transaction IDs to be assigned by third parties. Rule 901(h) requires that all information required by rule 901 be transmitted electronically in a format required by the registered SDR.

Rule 901(i) requires reporting of pre-enactment security-based swaps and transitional security-based swaps to the extent that information about such transactions is available.

2. Use of information

The security-based swap transaction information required to be reported pursuant to rule 901 will be used by registered SDRs, market participants, the Commission, and other relevant authorities. The information reported pursuant to rule 901 will be used by registered SDRs to publicly disseminate reports of security-based swap transactions, as well as to offer a resource for us and other relevant authorities to obtain detailed information about the security-based swap market. Market participants will use the public market data feed, among other things, to assess the current market for security-based swaps and to assist in the valuation of their own positions. We and other relevant authorities will use information about security-based swap transactions reported to and held by registered SDRs to monitor and assess systemic risks, as well as for market surveillance purposes.

3. Respondents

Rule 901(a) assigns reporting duties for covered transactions. In the Regulation SBSR Adopting Release we maintained our preliminary estimate of 300 respondents.[446] Based on an

[446] See Regulation SBSR Adopting Release, 80 FR 14674; Cross-Border Proposing Release, 78 FR 31113 (lowering estimate of respondents from 1,000 to 300).

analysis of the TIW data, we estimate that the proposed amendments set forth in this release would result in an additional 120 respondents that would be required to report transactions under the proposed amendments to Regulation SBSR that are not already required to report under the Regulation SBSR as adopted. Per estimates discussed above regarding the programmatic costs and benefits of regulatory reporting and public dissemination, we estimated that these 120 new respondents will be made up of 90 persons and approximately 30 other persons that are registered broker-dealers (including registered SB SEFs).[447]

4. Total initial and annual reporting and recordkeeping burdens of rule 901 of Regulation SBSR

Pursuant to rule 901, covered transactions must be reported to a registered SDR or to the Commission. Together, sections (a), (b), (c), (d), (e), (h), and (j) of rule 901 set forth the parameters that govern how covered transactions are reported. Rule 901(i) addresses the reporting of pre-enactment and transitional security-based swaps. These reporting requirements impose initial and ongoing burdens on respondents. We preliminarily believe that these burdens would be a function of, among other things, the number of reportable events and the data elements required to be reported for each such event. Rule 901(f) requires a registered SDR to time stamp, to the second, all reported information, and rule 901(g) requires a registered SDR to assign a transaction ID to each security-based swap, or establish or endorse a methodology for transaction IDs to be assigned by third parties. These requirements impose initial and ongoing burdens on registered SDRs. We preliminarily believe that the proposed amendments addressed in this release would not impact the cost burdens resulting from rules 901(f) and 901(g) on

447 See section VI.B.3 and n.403, supra.

registered SDRs because the number of respondents does not impact our calculation of these costs.[448] Therefore we do not address the costs associated with these provisions.

For Respondents. The reporting hierarchy set forth in rule 901(a) is designed to place the duty to report covered transactions on counterparties who are most likely to have the resources and who are best able to support the reporting function.

Respondents that fall under the reporting hierarchy in rule 901(a)(2)(ii) incur certain burdens as a result thereof with respect to their reporting of covered transactions. As stated above, we preliminarily believe that an estimate of 120 additional respondents that would incur the duty to report under Regulation SBSR is reasonable for estimating collection of information burdens. This estimate includes all persons that would incur a reporting duty under proposed amendments to Regulation SBSR, that are not already subject to burdens under current rule 901.

In the Regulation SBSR Adopting Release, we estimated that there were likely to be approximately 3 million reportable events per year under rule 901.[449] We further estimated that approximately 2 million of these reportable events would consist of uncleared transactions. We estimated that 2 million of the 3 million total reportable events would consist of the initial reporting of security-based swaps as well as the reporting of any life cycle events. We also estimated that of the 2 million reportable events, approximately 900,000 would involve the reporting of new security-based swap transactions, and approximately 1,100,000 would involve the reporting of life cycle events under rule 901(e).

Based on our assessment of the effect of the proposed amendments to Regulation SBSR, we estimate that they would result in approximately 2,700 additional reportable events per year

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448 See Regulation SBSR Adopting Release, 80 FR 14676-77.

449 See Regulation SBSR Adopting Release, 80 FR 14675.

under rule 901. Taking a similar approach to the Regulation SBSR Adopting Release but also accounting for security-based swaps that would be reported by a registered broker-dealer, we estimate that, of the 2,700 new reportable events, 1,512 would involve the reporting of new security-based swap transactions, and approximately 1,188 would involve the reporting of life cycle events under rule 901(e).[450] Based on these estimates, we preliminarily believe that rule 901(a) would result in respondents having a total burden of 7.6 hours attributable to the initial reporting of security-based swaps by respondents to registered SDRs under rules 901(c) and 901(d) over the course of a year.[451] We further estimate that respondents would have a total burden of 5.9 hours attributable to the reporting of life cycle events under rule 901(e) over the course of a year.[452] Therefore, we preliminarily believe that the proposed amendments to Regulation SBSR would result in a total reporting burden for respondents under rules 901(c) and 901(d) along with the reporting of life cycle events under rule 901(e) of 13.5 burden hours per year. We continue to believe that many reportable events would be reported through electronic means and that the ratio of electronic reporting to manual reporting is likely to increase over

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450 As noted above, we expect that 20% of the new reportable events would be reported by registered broker-dealers pursuant to 901(a)(2)(ii)(E)(4) and thus would involve the reporting only of new security-based swap transactions and not of life-cycle events. See note 403, supra. Under this assumption, we would expect 540 reportable events (2,700 * 0.2) to be new security-based swap transactions reported by registered broker-dealers, and 972 reportable events to be other new security-based swap transactions that would be required to be reported under the proposed rule ((2,700 - 540) * 0.45), for a total of 1,512 reportable events that are new security-based swap transactions. The remaining 1,188 reportable events ((2,700 - 540) * 0.55) would be life-cycle events reportable under rule 901(e). Cf. Regulation SBSR Adopting Release, 80 FR 14676.

451 In the Regulation SBSR Proposing Release, we estimated that it would take approximately 0.005 hours for each security-based swap transaction to be reported. See 75 FR at 75249 n.195. We calculate the following: ((1,512* 0.005) / (120 respondents)) = 0.06 burden hours per respondent or 7.6 total burden hours attributable to the initial reporting of security-based swaps.

452 In the Regulation SBSR Proposing Release, we estimated that it would take approximately 0.005 hours for each security-based swap transaction to be reported. See 75 FR at 75249 n.195. We calculate the following: ((1,188 * 0.005) / (120 respondents)) = 0.05 burden hours per reporting side or 5.9 total burden hours attributable to the reporting of life cycle events under rule 901(e).

time. We continue to believe that the bulk of the burden hours estimated above would be attributable to manually reported transactions.[453] Thus, respondents that capture and report transactions electronically would likely incur fewer burden hours than those respondents that capture and report transactions manually.

Based on the foregoing and applying the same calculation methods used in the Regulation SBSR Adopting Release, we estimate that rule 901, as proposed in this release, would impose an estimated total first-year burden of approximately 1,361 hours[454] per respondent for a total first-year burden of 163,320 hours for all respondents that would incur the duty to report under the proposed amendments to rule 901(a)(2)(ii)(E).[455] We estimate that rule 901, when applied to new respondents resulting from the proposed amendments to rule 901(a), would impose ongoing annualized aggregate burdens of approximately 654 hours[456] per respondent for a total aggregate annualized burden of 78,480 hours for all new respondents.[457] We further estimate that rule 901 would impose initial and ongoing annualized dollar cost

453 See Regulation SBSR Adopting Release, 80 FR 14676.

454 We derived our estimate from the following: (355 hours (one-time hourly burden for establishing an OMS) + 172 hours (one-time hourly burden for establishing security-based swap reporting mechanisms) + 180 hours (one-time hourly burden for compliance and ongoing support) = 707 hours (one-time total hourly burden). See Regulation SBSR Proposing Release, 75 FR 75248-50 nn.186, 194, and 201. (436 hours (annual-ongoing hourly burden for internal order management) + 0.11 hours (revised annual-ongoing hourly burden for security-based swap reporting mechanisms) + 218 hours (annual-ongoing hourly burden for compliance and ongoing support) = 654 hours (one-time total hourly burden. See id. 75248-50 nn.187 and 201 (707 one-time hourly burden + 654 revised annual-ongoing hourly burden = 1,361 total first-year hourly burden).

455 We derived our estimate from the following: (1,361 hours per respondent * 120 respondents) = 163,320 hours.

456 See Regulation SBSR Adopting Release, 80 FR 14676 (citing Cross-Border Adopting Release, 78 FR 31112-15).

457 We derived our estimate from the following: (654 hours per respondent * 120 respondents) = 78,480 hours.

burdens of $201,000 per respondent, for total aggregate initial and ongoing annualized dollar cost burdens of $24,120,000.[458]

C. Correction of Errors in Security-Based Swap Information—Rule 905

Rule 905, as adopted, establishes procedures for correcting errors in reported and disseminated security-based swap information. The title of this collection is "Rule 905—Correction of Errors in Security-Based Swap Information."

1. Summary of collection of information

Rule 905 establishes duties for security-based swap counterparties and registered SDRs to correct errors in information that previously has been reported.

Counterparty Reporting Error. Under rule 905(a)(1), where a side that was not the respondent for a security-based swap transaction discovers an error in the information reported with respect to such security-based swap, the counterparty must promptly notify the respondent of the error. Under rule 905(a)(2), where a respondent for a security-based swap transaction discovers an error in the information reported with respect to a security-based swap, or receives notification from its counterparty of an error, the respondent must promptly submit to the entity to which the security-based swap was originally reported an amended report pertaining to the original transaction. The amended report must be submitted to the registered SDR in a manner consistent with the policies and procedures of the registered SDR required pursuant to rule 907(a)(3).

Duty of Registered SDR to Correct. Rule 905(b) sets forth the duties of a registered SDR relating to corrections. If the registered SDR either discovers an error in a transaction on its system or receives notice of an error from a respondent, rule 905(b)(1) requires the registered

458 See Regulation SBSR Adopting Release, 80 FR 14676 nn.1066 and 1078. We derived our estimate from the following: ($201,000 per respondent * 120 respondents) = $24,120,000.

SDR to verify the accuracy of the terms of the security-based swap and, following such verification, promptly correct the erroneous information contained in its system. Rule 905(b)(2) further requires that, if such erroneous information relates to a security-based swap that the registered SDR previously disseminated and falls into any of the categories of information enumerated in rule 901(c), the registered SDR must publicly disseminate a corrected transaction report of the security-based swap promptly following verification of the trade by the counterparties to the security-based swap, with an indication that the report relates to a previously disseminated transaction.

2. Use of information

The security-based swap transaction information required to be reported pursuant to rule 905 will be used by registered SDRs, participants of those SDRs, the Commission, and other relevant authorities. Participants will be able to use such information to evaluate and manage their own risk positions and satisfy their duties to report corrected information to a registered SDR. A registered SDR will need the required information to correct security-based swap transaction records, in order to maintain an accurate record of a participant's positions as well as to disseminate corrected information. The Commission and other relevant authorities will need the corrected information to have an accurate understanding of the market for surveillance and oversight purposes.

3. Respondents

Rule 905 applies to all participants of registered SDRs. As noted above, we estimated that there would be approximately 300 respondents that incur the duty to report security-based swap transactions pursuant to current rule 901. As noted above, we preliminarily estimate that an additional 120 respondents would incur the duty to report under the proposed amendments to Regulation SBSR. Because any of these additional participants could become aware of errors in their reported transaction data, we estimate that there may be 120 respondents for purposes of the proposed amendments.

4. Total initial and annual reporting and recordkeeping burdens

The duty to promptly submit amended transaction reports to the appropriate registered SDR after discovery of an error, as required under rule 905(a)(2), will impose burdens on respondents. The duty to promptly notify the relevant respondent after discovery of an error, as required under rule 905(a)(1), will impose burdens on non-reporting participants.

With respect to respondents, we preliminarily believe that rule 905(a) will impose an initial, one-time burden associated with designing and building the respondent's reporting system to be capable of submitting amended security-based swap transactions to a registered SDR. We continue to believe that designing and building appropriate reporting system functionality to comply with rule 905(a)(2) would be a component of, and represent an incremental "add-on" to, the cost to build a reporting system and develop a compliance function as required under existing rule 901. Based on discussions with industry participants, we previously estimated this incremental burden to be equal to 5% of the one-time and annual burdens associated with designing and building a reporting system that is in compliance with rule 901, plus 10% of the corresponding one-time and annual burdens associated with developing the respondent's overall compliance program required under rule 901.[459] This estimate was based on similar calculations contained in the Regulation SBSR Proposing Release,[460] updated to reflect new estimates relating to the number of reportable events and the number of entities with reporting duties. Taking a similar approach with respect to the proposed amendments to Regulation SBSR, we

459 See Regulation SBSR Adopting Release, 80 FR 14682.

460 See Regulation SBSR Proposing Release, 75 FR 75254.

estimate that the new respondents would incur, as a result of rule 905(a), an initial (first-year) aggregate burden of 5,808.7 hours, which is 48.4 burden hours per respondent,[461] and an ongoing aggregate annualized burden of 2,616.7 hours, which is 21.8 burden hours per respondent.[462]

We preliminarily believe that the actual submission of amended transaction reports required under rule 905(a)(2) would not result in a material burden because this would be done electronically though the reporting system that the respondent must develop and maintain to comply with rule 901. The overall burdens associated with such a reporting system are addressed in our analysis of rule 901.[463]

D. Policies and Procedures for Registered Broker-Dealers—Rule 906(c)

1. Summary of collection of information

The proposed amendments to rule 906(c) would require each participant that is a registered broker-dealer that becomes a participant solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4) to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with applicable security-based swap transaction reporting obligations. Each such participant also would be required to review and update its policies and procedures at least annually.

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461 This figure is calculated as follows: [(((172 burden hours for one-time development of reporting system) x (0.05)) + ((0.11 burden hours annual maintenance of reporting system) x (0.05)) + ((180 burden hours one-time compliance program development) x (0.1)) + ((218 burden hours annual support of compliance program) x (0.1))) x (120 respondents)] = 5,808.7 burden hours, which is 48.4 burden hours per respondent.

462 This figure is calculated as follows: [(((0.11 burden hours annual maintenance of reporting system) x (0.05)) + ((218 burden hours annual support of compliance program) x (0.1))) x (120 respondents)] = 2,616.7 burden hours, which is 21.8 burden hours per respondent.

463 See Section VII.B, supra.

2. Use of information

The policies and procedures required under the proposed amendments to rule 906(c) would be used by participants to aid in their compliance with Regulation SBSR, and also used by the Commission as part of its ongoing efforts to monitor and enforce compliance with the federal securities laws, including Regulation SBSR, through, among other things, examinations and inspections.

3. Respondents

The proposed amendments to rule 906(c) would result in the rule applying to registered broker-dealers that are likely to become participants solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4). The Commission estimates that there would be 30 such registered broker-dealers.

4. Total initial and annual reporting and recordkeeping burdens

The proposed amendment to rule 906(c) would require each registered broker-dealer that is likely to become a participant solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4) to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with applicable security-based swap transaction reporting obligations. The proposed amendment to rule 906(c) also would require each such registered broker-dealer to review and update such policies and procedures at least annually. We estimate that the one-time, initial burden for each such registered broker-dealer to adopt written policies and procedures as required under the proposed amendments to rule 906(c) would be similar to the rule 906(c) burdens discussed in the Regulation SBSR Adopting Release for covered participants, and would be approximately 216 burden hours per registered broker-dealer.[464] As discussed in the Regulation SBSR Adopting Release,[465] this figure is based on the estimated number of hours to develop a set of written policies and procedures, program systems, implement controls and oversight, train relevant employees, and perform necessary testing. In addition, we estimate the burden of maintaining such policies and procedures, including a full review at least annually would be approximately 120 burden hours for each registered broker-dealer that is likely to become a participant solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4).[466] This figure includes an estimate of hours related to reviewing existing policies and procedures, making necessary updates, conducting ongoing training, maintaining controls systems, and performing necessary testing. Accordingly, the Commission estimates that the initial aggregate annualized burden associated with the proposed amendments to rule 906(c) would be 10,080 burden hours, which corresponds to 336 burden hours per registered broker-dealer that is likely to become a participant solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4).[467] The Commission estimates that the ongoing aggregate annualized burden associated with the proposed amendments to rule 906(c) would be 3,600 burden hours, which

464 See Regulation SBSR Adopting Release, 80 FR 14684. This figure is based on the following: [(Sr. Programmer at 40 hours) + (Compliance Manager at 40 hours) + (Compliance Attorney at 40 hours) + (Compliance Clerk at 40 hours) + (Sr. Systems Analyst at 32 hours) + (Director of Compliance at 24 hours)] = 216 burden hours per registered broker-dealer that is likely to become a participant solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4).

465 See id.

466 See id. This figure is based on the following: [(Sr. Programmer at 8 hours) + (Compliance Manager at 24 hours) + (Compliance Attorney at 24 hours) + (Compliance Clerk at 24 hours) + (Sr. Systems Analyst at 16 hours) + (Director of Compliance at 24 hours)] = 120 burden hours per registered clearing agency or platform.

467 This figure is based on the following: [(216 + 120 burden hours) x (30 registered broker-dealers that are likely to become a participant solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4))] = 10,080 burden hours.

corresponds to 120 burden hours per registered broker-dealer that is likely to become a participant solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4).[468]

E. Collection of Information is Mandatory

Each collection of information discussed above is mandatory.

F. Confidentiality of Responses to Collection of Information

Information collected pursuant to rule 905 would be widely available to the extent that it corrects information previously reported pursuant to rule 901(c) and incorporated into security-based swap transaction reports that are publicly disseminated by a registered SDR pursuant to rule 902. Most of the information required under rule 902 would be widely available to the public to the extent it is incorporated into security-based swap transaction reports that are publicly disseminated by a registered SDR pursuant to rule 902. However, rule 902(c) prohibits public dissemination of certain kinds of transactions and certain kinds of transaction information. An SDR, pursuant to section 13(n)(5) of the Exchange Act and rules 13n-4(b)(8) and 13n-9 thereunder is required to maintain the privacy of this security-based swap information. To the extent that we receive confidential information pursuant to this collection of information, we anticipate that we will keep such information confidential, subject to the provisions of applicable law. The proposed amendments to rule 906(c) would require certain registered broker-dealers to establish, maintain, and enforce certain written policies and procedures. The collection of information required by rule 906(c) would not be widely available. To the extent that the

468 This figure is based on the following: [(120 burden hours) x (30 registered broker-dealers that are likely to become a participant solely as a result of making a report to satisfy an obligation under proposed rule 901(a)(2)(ii)(E)(4))] = 3,600 burden hours.

Commission receives confidential information pursuant to this collection of information, we anticipate that we would keep such information confidential, subject to applicable law.

G. Request for comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comment to:

- Evaluate whether the proposed collection of information is necessary for the proper performance of our functions, including whether the information shall have practical utility;
- Evaluate the accuracy of our estimate of the burden of the proposed collection of information;

  Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
- Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090, with reference to File Number S7-06-15. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File Number S7-06-15 and be submitted to the Securities and Exchange Commission, Office of FOIA/PA Services, 100 F Street NE., Washington, DC 20549-2736. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA")[469] the Commission requests comment on the potential effect of these proposed amendments on the United States economy on an annual basis. The Commission also requests comment on any potential increases in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

IX. Regulatory Flexibility Act Certification

A. Certification for Proposed Rule and Proposed Amendments to Exchange Act Rules 3a71-3 and 3a71-5

Section 3(a) of the Regulatory Flexibility Act of 1980 ("RFA")[470] requires the Commission to undertake an initial regulatory flexibility analysis of the impact of the proposed rule amendments on small entities unless the Commission certifies that the rule, if adopted, would not have a significant impact on a substantial number of "small entities."[471]

For purposes of Commission rulemaking in connection with the RFA,[472] a small entity includes: (1) when used with reference to an "issuer" or a "person," other than an investment

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469 Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

470 5 U.S.C. 603(a).

471 5 U.S.C. 605(b)

472 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 (January, 28, 1982), 47 FR 5215 (February, 4, 1982) (File No. AS-305).

company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less;[473] 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,[474] 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.[475] 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, entities with $175 million or less in assets;[476] (ii) for entities engaged in non-depository credit intermediation and certain other activities, entities with $7 million or less in annual receipts;[477] (iii) for entities engaged in financial investments and related activities, entities with $7 million or less in annual receipts;[478] (iv) for insurance carriers and entities engaged in related activities, entities with $7 million or less in annual receipts;[479] and (v) for funds, trusts, and other financial vehicles, entities with $7 million or less in annual receipts.[480]

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473 See 17 CFR 240.0-10(a).

474 See 17 CFR 240.17a-5(d).

475 See 17 CFR 240.0-10(c).

476 See 13 CFR 121.201 (Subsector 522).

477 See id. at Subsector 522.

478 See id. at Subsector 523.

479 See id. at Subsector 524.

480 See id. at Subsector 525.

As we stated in the Cross-Border Adopting Release, 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 would not be "small entities" for purposes of the RFA.[481] Based on feedback from market participants and our information about the security-based swap markets, we believe that firms that are likely to engage in security-based swap dealing activity at levels that may lead them to perform de minimis calculations under the "security-based swap dealer" definition are large financial institutions that exceed the thresholds defining "small entities" as set forth above. Accordingly, the Commission preliminarily believes that it is unlikely that the proposed amendments regarding the registration of security-based swap dealers would have a significant economic impact on a substantial number of small entities.

For the foregoing reasons, the Commission certifies that the proposed rule and amendments to Exchange Act 3a71-3 and 3a71-5 would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. We encourage written comments regarding this certification. We request that commenters describe the nature of any impact on small entities and provide empirical data to illustrate the extent of the impact.

B. Initial Regulatory Flexibility Analysis for Proposed Amendments to Regulation SBSR

The Commission has prepared this Initial Regulatory Flexibility Act Analysis in accordance with 5 U.S.C. 603. This initial Regulatory Flexibility Act Analysis relates to the proposed amendments to Regulation SBSR under the Exchange Act, specifically rules 900, 901, 906, 907, and 908 under the Exchange Act.

481 See Cross-Border Adopting Release, 79 FR 47368.

1. Reasons for, and Objectives of, the Proposed Action and Legal Basis

The primary reason for, and objective of, the proposed amendments to Regulation SBSR is to address the application of the regulatory reporting and public dissemination requirements to certain transactions not addressed in the Regulation SBSR Adopting Release or the Regulation SBSR Proposed Amendments Release and to incorporate our revised approach to transactions of non-U.S. persons who are engaged in dealing activity from a location in the United States into Regulation SBSR. Pursuant to Exchange Act sections 13A(a)(1), 13(m)(1)(G), 13(m)(1)(B)-(D), and 13(n)(5)(D)(ii), the Commission is proposing amendments to Regulation SBSR regarding the reporting and public dissemination of certain security-based swap transactions.[482]

Proposed rule 908(a)(1)(v) would require a security-based swap transaction connected with a non-U.S. person's security-based swap dealing activity that is arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of such non-U.S. person's agent located in a U.S. branch or office, to be reported to a registered SDR and publicly disseminated. Requiring these transactions to be reported to a registered SDR should enhance our ability to oversee relevant activity related to security-based swap dealing occurring within the United States as well as our ability to monitor market participants for compliance with specific Title VII requirements.[483] It should also improve our ability to monitor for manipulative and abusive practices involving security-based swap transactions or transactions in related underlying assets, such as corporate bonds or other securities transactions that result from dealing activity, or other relevant activity, in the U.S.

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[482] See Section V.E, supra.

[483] See section V.E.2(a), supra.

market.[484] Subjecting these transactions to the public dissemination requirements of Regulation SBSR should enhance the level of transparency in the U.S. security-based swap market, potentially reducing implicit transaction costs and promoting greater price efficiency.[485] Ensuring that post-trade information encompasses transactions involving a non-U.S. person that arranged, negotiated, or executed the security-based swap in connection with its dealing activity using personnel (personnel of an agent) located in a U.S. branch or office, could increase price competition and price efficiency in the security-based swap market and should enable all market participants to have more comprehensive information with which to make trading and valuation determinations.[486]

Proposed rule 908(a)(1)(iii) would require a security-based swap transaction that is executed on a platform having its principal place of business in the United States to be reported to a registered SDR and publicly disseminated pursuant to Regulation SBSR. Requiring these security-based swaps to be reported to a registered SDR would permit the Commission and other relevant authorities to observe, in a registered SDR, all transactions executed on such a platform and to carry out oversight of such security-based swaps. Furthermore, we preliminarily believe that public dissemination of such transactions would have value to participants in the U.S. security-based swap market, who are likely to trade the same or similar products, as these products would have been listed by a platform having its principal place of business in the United States.[487]

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484 Id.

485 See id. and note 325, supra.

486 See section V.E.2(a), supra.

487 See section V.E.2(b), supra.

Proposed rule 908(a)(1)(iv) would require a security-based swap transaction that is effected by or through a registered broker-dealer (including a registered SB SEF) to be reported to a registered SDR and publicly disseminated pursuant to Regulation SBSR. Under proposed rule 908(a)(2)(ii)(E)(4), the registered broker-dealer would be required to report the transaction if neither side includes a U.S. person, a registered security-based swap dealer, a registered major security-based swap participant, or a non-U.S. person who arranged, negotiated, or executed the security-based swap from a location in the United States. Registered broker-dealers play a key role as intermediaries in the U.S. financial markets. To improve integrity and transparency in those markets, we believe that it is important that the Commission, and other relevant authorities, have ready access to detailed information about the security-based swap transactions that such persons intermediate. Furthermore, we preliminarily believe that public dissemination of such transactions would have value to participants in the U.S. security-based swap market, who are likely to trade the same or similar products.[488]

2. Small Entities Subject to the Proposed Rules

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;[489] 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 Exchange Act rule 17a-5(d),[490] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated

488 See section V.E.2(c), supra.

489 See 17 CFR 240.0-10(a).

490 See 17 CFR 240.17a-5(d).

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.[491] 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, entities with $175 million or less in assets;[492] (ii) for entities engaged in non-depository credit intermediation and certain other activities, entities with $7 million or less in annual receipts;[493] (iii) for entities engaged in financial investments and related activities, entities with $7 million or less in annual receipts;[494] (iv) for insurance carriers and entities engaged in related activities, entities with $7 million or less in annual receipts;[495] and (v) for funds, trusts, and other financial vehicles, entities with $7 million or less in annual receipts.[496]

As noted in the Regulation SBSR Proposed Amendments Release, we believe, based on input from security-based swap market participants, that the majority of security-based swap transactions have at least one counterparty that is either a security-based swap dealer or major security-based swap participant, and that these entities—whether registered broker-dealers or not—would exceed the thresholds defining "small entities" set out above.[497] For this reason, we continue to believe that the majority of proposed amendments to Regulation SBSR would not

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491 See 17 CFR 240.0-10(c).

492 See 13 CFR 121.201 (Subsector 522).

493 See id. at Subsector 522.

494 See id. at Subsector 523.

495 See id. at Subsector 524.

496 See id. at Subsector 525.

497 See Regulation SBSR Proposed Amendments Release, 80 FR 14801. See also Regulation SBSR Adopting Release, 80 FR 14727-28.

have a significant economic impact on a substantial number of small entities for purposes of the RFA. However, the proposed amendments would require registered broker-dealers (including a registered SB SEF) to report a security-based swap transaction that is effected by or through it. As noted above, we estimate that 30 registered broker-dealers (including registered SB SEFs) may be required to report such transactions,[498] though we are not able to estimate the number of these registered broker-dealers that would be "small entities." Given the nature of the security-based swap market, we preliminarily believe that it is unlikely that these registered broker-dealers would be small entities, though we request comment on the number of registered broker-dealers that are small entities that would be impacted by our proposed amendments, including any available empirical data.

3. Projected Reporting, Recordkeeping and Other Compliance Requirements

As discussed above, the proposed amendments to Regulation SBSR would require a security-based swap transaction that is effected by or through a registered broker-dealer (including a registered SB SEF) to be reported to a registered SDR by the registered broker-dealer if neither side of the security-based swap transaction includes a U.S. person, a registered security-based swap dealer, a registered major security-based swap participant, or a non-U.S. person who arranged, negotiated, or executed the security-based swap from a location in the United States. We preliminarily believe, as discussed above, that registered broker-dealers (including registered SB SEFs) would incur certain assessment costs associated with performing an analysis of their clients (in the case of registered-broker dealers) and members (in the case of registered SB SEFs)[499] to determine whose trades they are obligated to report under the proposed

498 See section VII.B.3, supra.

499 See section VI.A.1, supra.

rules, which would be supported by systems that would record and maintain this information over time.[500]

Additionally, under the proposed amendments to rule 906(c), these registered broker-dealers would be required to establish, maintain, and enforce policies and procedures that are reasonably designed to ensure that the registered broker-dealer complies with any obligations to report information to a registered security-based swap data repository in a manner consistent with Regulation SBSR. Further, these registered broker-dealers would be required to review these policies and procedures at least annually.[501]

4. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes there are no rules that duplicate, overlap, or conflict with the proposed amendments.

5. Significant Alternatives

Pursuant to section 3(a) of the Regulatory Flexibility Act,[502] the Commission must consider certain types of alternatives, including: (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

We are proposing to require registered broker-dealers (including registered SB SEFs) to report security-based swap transactions that are effected by or through it if neither side of the

500 Id.

501 See section VI.B.3, supra.

502 5 U.S.C. 603(c)

security-based swap transaction includes a U.S. person, a registered security-based swap dealer, a registered major security-based swap participant, or a non-U.S. person who arranged, negotiated, or executed the security-based swap from a location in the United States. The proposed amendments would enable the Commission to gain a better understanding of the security-based swap market, including the size and scope that market, and should enable us to identify exposure to risks undertaken by individual market participants or at various levels of aggregation, as well as credit exposures that arise between counterparties.[503] The regulatory data collected as a result of the proposed amendments would enable us to conduct robust monitoring of the security-based swap market for potential risks to financial stability.[504] The Commission considered whether it is necessary or appropriate to establish different compliance and reporting requirements under the rule; or clarify, consolidate, or simplify the compliance and reporting requirements for small entities under the rule. Because the proposed rule amendments would enhance the Commission's ability to oversee relevant activity related to security-based swap dealing occurring within the United States, our ability to monitor market participants for compliance with specific Title VII requirements, and our ability to monitor for manipulative and abusive practices involving security-based swap transactions, we preliminarily believe that small entities should be covered by the proposed amendments to Regulation SBSR. We preliminarily believe that establishing different compliance or reporting requirements for small entities, or exempting small entities from the proposed amendments could complicate the rules and potentially create gaps in the regulatory data that is reported and publicly disseminated that would be inconsistent with the goals of Title VII and the proposed amendments. Additionally,

503 See Section VI.B.3, supra.

504 See Section VI.B.3, supra.

we do not consider performance rather than design standards to be consistent with the statutory mandate requiring reporting of security-based swaps to registered SDRs and the public dissemination of transaction and pricing data to enhance price discovery of security-based swaps.[505]

6. Solicitation of Comment

We are soliciting comments regarding this analysis. We request comment on the number of small entities that would be subject to the amendments and whether the proposed amendments would have any effects that have not been discussed. We request that commenters describe the nature of any effects on small entities subject to the amendments and provide empirical data to support the nature and extent of the effects.

X. Statutory Basis and Text of Proposed Rules

Pursuant to the Exchange Act, 15 U.S.C. § 78a et seq., and particularly, Sections 3(b), 23(a)(1), 3C(e), 11A(b), 13(m)(1), 13A(a), 17(a), and 30(c) thereof, Sections 712(a)(2), (6), and 761(b) of the Dodd-Frank Act, the SEC is proposing to amend rules 3a71-3 and 3a71-5, and 900, 901, 906, 907 and 908, under the Exchange Act.

List of Subjects

17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Part 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

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505 See Exchange Act sections 13(m)(1)(G) and 13(m)(1)(B).

Text of Proposed rules

For the reasons stated in the preamble, the SEC is proposing to amend Title 17, Chapter II of the Code of the Federal Regulations as follows:

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

1. The general authority citation for part 240 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, 78*l*, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78*ll*, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376, (2010) unless otherwise noted.

* * * * *

Sections 3a71-3 and 3a71-5 are also issued under Pub. L. 111-203, §§ 712, 761(b), 124 Stat. 1754 (2010), and 15 U.S.C. 78dd(c).

* * * * *

2. § 240.3a71-3 is amended by:

a. Adding paragraphs (a)(6) through (a)(9);
b. Adding paragraph (b)(1)(iii)(C); and
c. Adding paragraph (c).

The additions read as follows:

§ 240.3a71-3 Cross-border security-based swap dealing activity.

(a) * * *

(5) * * *

(6) U.S. security-based swap dealer means a security-based swap dealer, as defined in section 3(a)(71) of the Act (15 U.S.C. 78c(a)(71)), and the rules and regulations thereunder, that is a U.S. person.

(7) Foreign security-based swap dealer means a security-based swap dealer, as defined in section 3(a)(71) of the Act (15 U.S.C. 78c(a)(71)), and the rules and regulations thereunder, that is not a U.S. person.

(8) U.S. business means:

(i) With respect to a foreign security-based swap dealer:

(A) Any security-based swap transaction entered into, or offered to be entered into, by or on behalf of such foreign security-based swap dealer, with a U.S. person (other than a transaction conducted through a foreign branch of that person); or

(B) Any security-based swap transaction arranged, negotiated, or executed by personnel of the foreign security-based swap dealer located in a U.S. branch or office, or by personnel of an agent of the foreign security-based swap dealer located in a U.S. branch or office; and

(ii) With respect to a U.S. security-based swap dealer, any transaction by or on behalf of such U.S. security-based swap dealer, wherever entered into or offered to be entered into, other than a transaction conducted through a foreign branch with a non-U.S. person or with a U.S.-person counterparty that constitutes a transaction conducted through a foreign branch of the counterparty.

(9) Foreign business means security-based swap transactions that are entered into, or offered to be entered into, by or on behalf of, a foreign security-based swap dealer or a U.S. security-based swap dealer, other than the U.S. business of such person.

(b) * * *

(1) * * *

(iii) * * *

(C) Security-based swap transactions connected with such person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office; and

* * * * *

(c) Application of customer protection requirements. A registered foreign security-based swap dealer and a registered U.S. security-based swap dealer, with respect to their foreign business, shall not be subject to the requirements relating to business conduct standards described in section 15F(h) of the Act (15 U.S.C. 78o-10(h)), and the rules and regulations thereunder, other than the rules and regulations prescribed by the Commission pursuant to section 15F(h)(1)(B) of the Act (15 U.S.C. 78o-10(h)(1)(B)).

3. § 240.3a71-5 is amended by adding paragraph (c) to read as follows:

* * * * *

§ 240.3a71-5 Exception for cleared transactions executed on a swap execution facility.

* * * * *

(c) The exceptions in paragraphs (a) and (b) of this section shall not apply to any security-based swap transactions of a non-U.S. person connected with its security-based swap dealing activity that are arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office.

* * * * *

PART 242 — REGULATIONS M, SHO, ATS, AC, NMS, AND SCI AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

4. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-l(c), 78*l*, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

5. § 242.900 is further amended, as proposed at 80 FR 14801 (March 19, 2015), by:

a. In paragraph (u)(3), removing the period and adding in its place "; or"; and

b. Adding paragraph (u)(4) to read as follows:

§ 242.900 Definitions

* * * * *

(u) * * *

(4) A registered broker-dealer (including a registered security-based swap execution facility) that is required to report a security-based swap to that registered security-based swap data repository by § 242.901(a).

* * * * *

6. § 242.901 is amended by:

a. Adding paragraphs (a)(2)(ii)(E)(2) through (4); and

b. Revising paragraph (d)(9).

The additions and revision read as follows:

§ 242.901 Reporting obligations.

(a) * * *

(2) * * *

(ii) * * *

(E) * * *

(2) If one side includes a non-U.S. person that falls within § 242.908(b)(5) or a U.S. person and the other side includes a non-U.S. person that falls within rule § 242.908(b)(5), the sides shall select the reporting side.

(3) If one side includes only non-U.S. persons that do not fall within § 242.908(b)(5) and the other side includes a non-U.S. person that falls within rule § 242.908(b)(5) or a U.S. person, the side including a non-U.S. person that falls within rule § 242.908(b)(5) or a U.S. person shall be the reporting side.

(4) If neither side includes a U.S. person and neither side includes a non-U.S. person that falls within § 242.908(b)(5) but the security-based swap is effected by or through a registered broker-dealer (including a registered security-based swap execution facility), the registered broker-dealer (including a registered security-based swap execution facility) shall report the information required by §§ 242.901(c) and 242.901(d).

* * * * *

(d) * * *

(9) The platform ID, if applicable, or if a registered broker-dealer (including a registered security-based swap execution facility) is required to report the security-based swap by § 242.901(a)(2)(ii)(E)(4), the broker ID of that registered broker-dealer (including a registered security-based swap execution facility);

* * * * *

7. § 242.906 is amended by revising paragraphs (b) and (c) to read as follows:

§ 242.906 Other duties of participants.

(a) * * *

(b) Duty to provide ultimate parent and affiliate information. Each participant of a registered security-based swap data repository that is not a platform, a registered clearing agency, or a registered broker-dealer (including a registered security-based swap execution facility) that becomes a participant solely as a result of making a report to satisfy an obligation under § 242.901(a)(2)(ii)(E)(4) shall provide to the registered security-based swap data repository information sufficient to identify its ultimate parent(s) and any affiliate(s) of the participant that also are participants of the registered security-based swap data repository, using ultimate parent IDs and counterparty IDs. Any such participant shall promptly notify the registered security-based swap data repository of any changes to that information.

(c) Policies and procedures to support reporting compliance. Each participant of a registered security-based swap data repository that is a security-based swap dealer, major security-based swap participant, registered clearing agency, registered broker-dealer (including a registered security-based swap execution facility) that becomes a participant solely as a result of making a report to satisfy an obligation under § 242.901(a)(2)(ii)(E)(4), or platform shall establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure that it complies with any obligations to report information to a registered security-based swap data repository in a manner consistent with §§ 242.900 through 242.909. Each such participant shall review and update its policies and procedures at least annually.

* * * * *

8. § 242.907 is amended by revising paragraph (a)(6) to read as follows:

§ 242.907 Policies and procedures of registered security-based swap data repositories.

(a) * * *

(6) For periodically obtaining from each participant other than a platform, a registered clearing agency, or a registered broker-dealer (including a registered security-based swap execution facility) that becomes a participant solely as a result of making a report to satisfy an obligation under § 242.901(a)(2)(ii)(E)(4) information that identifies the participant's ultimate parent(s) and any participant(s) with which the participant is affiliated, using ultimate parent IDs and counterparty IDs.

* * * * *

9. § 242.908 is amended by adding paragraphs (a)(1)(iii) through (v); and is further amended as proposed at 80 FR 14801 (March 19, 2015), by adding paragraph (b)(5) to read as follows:

§ 242.908 Cross-border matters.

(a) * * *

(1) * * *

(iii) The security-based swap is executed on a platform having its principal place of business in the United States;

(iv) The security-based swap is effected by or through a registered broker-dealer (including a registered security-based swap execution facility); or

(v) The transaction is connected with a non-U.S. person's security-based swap dealing activity and is arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office.

* * * * *

(b) * * *

(1) * * *

(5) A non-U.S. person that, in connection with such person's security-based swap dealing activity, arranged, negotiated, or executed the security-based swap using its personnel located in a U.S. branch or office, or using personnel of an agent located in a U.S. branch or office.

By the Commission.

Dated: April 29, 2015

Brent J. Fields
Secretary

Commissioner Gallagher
Commissioner Piwowar
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 240, 249

Release No. 34-74835; File No. S7-07-15

RIN 3235-AL00

PAY VERSUS PERFORMANCE

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing amendments to Item 402 of Regulation S-K to implement Section 14(i) of the Securities Exchange Act of 1934 (the "Exchange Act"), as added by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Section 14(i) directs the Commission to adopt rules requiring registrants to disclose in a clear manner the relationship between executive compensation actually paid and the financial performance of the registrant. The proposed disclosure would be required in proxy or information statements in which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required. The proposed disclosure requirements would not apply to emerging growth companies or foreign private issuers.

DATES: Comments should be received on or before [insert date 60 days after publication in the Federal Register].

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an E-mail to rule-comments@sec.gov. Please include File Number S7-07-15 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 Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-07-15. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the SEC's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Eduardo A. Aleman, Special Counsel, in the Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing to add new paragraph (v) to Item 402 of Regulation S-K.[1]

Table of Contents

1 17 CFR 229.402.

I. Introduction

We are proposing amendments today as required by Section 953(a) of the Dodd-Frank Act.[2] Section 953(a) added Section 14(i)[3] to the Exchange Act,[4] which directs the Commission to adopt rules requiring registrants[5] to disclose in any proxy or consent solicitation material for an annual meeting of shareholders a clear description of any compensation required to be disclosed by the issuer under Item 402 of Regulation S-K[6] (or any successor thereto), including information that shows the relationship between executive compensation actually paid and the financial performance of the registrant, taking into account any change in the value of the shares of stock and dividends of the registrant and any distributions. A report by the Senate Committee on Banking, Housing and Urban Affairs indicated that the rules mandated by Section 953(a) of the Dodd-Frank Act were not intended to be overly-prescriptive and that Congress recognized that there

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2 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3 15 U.S.C. 78n(i).

4 15 U.S.C. 78a et seq.

5 Section 102(a)(2) of the Jumpstart Our Business Startups Act ("JOBS Act") amended Exchange Act Section 14(i) to exclude registrants that are "emerging growth companies" from the pay-versus-performance disclosure requirements. Pub. L. No. 112-106, 126 Stat. 306 (2012). Section 3(a) of the Exchange Act [15 U.S.C. 78c(a)] defines an "emerging growth company" as an issuer with total annual gross revenues of less than $1 billion during its most recently completed fiscal year.

6 17 CFR 229.402.

could be many ways to disclose the relationship between executive compensation and financial performance of the registrant.[7]

Section 953(a) was enacted contemporaneously with other executive compensation-related provisions in the Dodd-Frank Act that are "designed to address shareholder rights and executive compensation practices."[8] Section 951 of the Dodd-Frank Act enacted new Exchange Act Section 14A[9] which requires that not less than every three years a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to a non-binding shareholder vote to approve the compensation of executives. Pursuant to the mandate in Section 14A, we adopted rules requiring a shareholder advisory vote to approve the compensation of the named executive officers ("NEOs"), as disclosed pursuant to Item 402 of Regulation S-K, at an annual or other meeting of shareholders at which directors will be elected and for which such executive compensation disclosure is required.[10]

We believe that the pay-versus-performance disclosure mandated by Section 953(a), and the disclosure of the ratio of the median annual total compensation of employees to the annual total compensation of the chief executive officer mandated by

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7 *See* Report of the Senate Committee on Banking, Housing and Urban Affairs to accompany S. 3217, S. REP. NO. 111-176, at 135 (2010) (the "Senate Report") which stated with respect to Section 953(a): "This disclosure about the relationship between executive compensation and the financial performance of the issuer may include a clear graphic comparison of the amount of executive compensation and the financial performance of the issuer or return to investors and may take many forms."

8 Dodd-Frank Act, H.R. Rep. 111-517, at 872 (2010).

9 15 U.S.C. 78n-1.

10 *See Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, Release No. 33-9178 (Jan. 25, 2011) [76 FR 6010] (Feb. 2, 2011).

Section 953(b),[11] are intended to provide shareholders with information that will help them assess a registrant's executive compensation when they are exercising their rights to cast advisory votes on executive compensation under Exchange Act Section 14A. The Senate Report accompanying the statute references shareholder interest in the relationship between executive pay and performance as well as the general benefits of transparency of executive pay practices.[12]

In that regard, the disclosure mandated by Section 14(i) of the Exchange Act will give shareholders a new metric for assessing a registrant's executive compensation relative to its financial performance. Currently, Item 402 of Regulation S-K specifies the information that must be included when the applicable form or schedule requires executive compensation disclosure. Information on financial performance is required by other items throughout Regulation S-K, including in Item 201(e),[13] Item 301,[14] Item 302[15] and Item 303.[16] There is currently no requirement to disclose specific information showing the relationship between executive compensation actually paid and the financial performance of the registrant. Instead, Item 402 of Regulation S-K contains detailed requirements for the disclosure of executive compensation and more principles-based

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11 We proposed rules to implement Section 953(b), *see Pay Ratio Disclosure*, Release No. 33-9452 (Sept. 18, 2013) [78 FR 60560] (Oct. 1, 2013).

12 The Senate Report includes the following with respect to Section 953 of the Dodd-Frank Act: "It has become apparent that a significant concern of shareholders is the relationship between executive pay and the company's financial performance...The Committee believes that these disclosures will add to corporate responsibility as firms will have to more clearly disclose and explain executive pay." *See* Senate Report, *supra* note 7.

13 17 CFR 229.201(e), Performance Graph.

14 17 CFR 229.301, Selected Financial Data.

15 17 CFR 229.302, Supplementary Financial Information.

16 17 CFR 229.303, Management's Discussion and Analysis of Financial Condition and Results of Operations.

disclosure requirements regarding the relationship between pay and performance. The Compensation Discussion and Analysis ("CD&A") required by Item 402(b) of Regulation S-K requires registrants to provide an explanation of "all material elements of the registrant's compensation of the named executive officers."[17] With respect to performance, Item 402(b)(2) includes non-exclusive examples of information that may be material, including (i) specific items of corporate performance taken into account in setting compensation policies and making compensation decisions; (ii) how specific forms of compensation are structured and implemented to reflect these items of the registrant's performance; and (iii) how specific forms of compensation are structured and implemented to reflect the NEO's individual performance and/or individual contribution to these items of the registrant's performance.[18]

The disclosure required by Exchange Act Section 14(i) can supplement the discussion in the CD&A as part of the shareholder's evaluation of the registrant's executive compensation practices and policies, including for purposes of the shareholder advisory vote on executive compensation. The proposed amendment provides a factual description of how the executive compensation actually paid related to the financial performance of the registrant.[19] This disclosure may provide a useful point of comparison for the analysis provided in the CD&A about a compensation committee's approach to linking pay and performance. We also believe that the proposed disclosure

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17 17 CFR 229.402(b)(1).

18 17 CFR 229.402(b)(2)(v)-(vii).

19 We recognize that financial performance of the registrant is a broad term and can mean different things to different registrants. Throughout this release, we use the term "financial performance" to refer to the financial performance of the registrant as required to be disclosed by new Section 14(i) of the Exchange Act, which we propose to measure by cumulative total shareholder return as defined in Item 201(e) of Regulation S-K. *See* Section II.E below.

may provide relevant information to shareholders when voting in an election of directors. By helping to inform a shareholder's assessment of a registrant's executive compensation, the new disclosure may help shareholders evaluate the directors' oversight of this important area.

As with other Dodd-Frank Act rulemakings, we have sought comment from the public prior to the issuance of a proposing release.[20] We have considered the pre-proposal comment letters received to date. Commenters were divided on whether we should provide specific rules on how the proposed disclosure must be prepared or whether we should allow registrants flexibility in determining how to disclose the relationship between pay and performance. Some commenters believed that we should propose specific requirements to encourage consistency and comparability across registrants.[21] Other commenters were supportive of an approach to pay-versus-performance disclosure in which our rules would not provide specific requirements, but would allow registrants to determine the substance of such disclosure and how such disclosure should be presented.[22]

As discussed in more detail below, our proposed amendments would require registrants to provide disclosure that can be compared across registrants, while also continuing to allow registrants to supplement their disclosure about pay-versus-

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20 Comments related to the executive compensation provisions of the Dodd-Frank Act are available at http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml.

21 *See* letters from Pay Governance LLC ("Pay Governance"), Farient Advisors ("Farient"), Compensia, Inc. ("Compensia"), Meridian Compensation Partners ("Meridian"), MDU Resources, Inc. ("MDU") and Shareholder Value Advisors, Inc. (October 4, 2010) ("SVA I").

22 *See* letters from the Center on Executive Compensation (September 1, 2010) ("CEC I"), American Bar Association ("ABA"), Protective Life Corporation ("Protective Life"), ClearBridge Compensation Group ("ClearBridge") and Davis Polk & Wardwell LLP ("Davis Polk").

performance to reflect the specific situation of the registrant and its industry. Throughout the release we seek comment on this approach, and whether alternative approaches should be considered to accomplish the objectives of Section 14(i) of the Exchange Act.

II. Proposed Amendment

A. Introduction

We are proposing new Item 402(v) of Regulation S-K that would require a registrant to provide a clear description of (1) the relationship between executive compensation actually paid to the registrant's NEOs and the cumulative total shareholder return (TSR) of the registrant, and (2) the relationship between the registrant's TSR and the TSR of a peer group chosen by the registrant, over each of the registrant's five most recently completed fiscal years.

The proposed amendments would:

- Require that the executive compensation used in calculating the executive compensation actually paid be total compensation as disclosed in the Summary Compensation Table,[23] modified to exclude changes in actuarial present value of benefits under defined benefit and actuarial pension plans that are not attributable to the applicable year of service, and to include the value of equity awards at vesting rather than when granted, which adjustments are intended to capture the Section 953(a) required measure of "executive compensation actually paid";[24]

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23 Item 402(c) of Regulation S-K [17 CFR 229.402(c)].

24 The terms "stock," "option," "stock appreciation right," "equity," "plan" and "incentive plan" used in this release are generally as defined in Item 402(a)(6) of Regulation S-K [17 CFR

- Require registrants to measure financial performance using TSR, as defined in Item 201(e) of Regulation S-K, and TSR of a registrant peer group;
- Require registrants to provide the executive compensation actually paid, total compensation as disclosed in the Summary Compensation Table, TSR, and peer group TSR in a prescribed table;
- Require the executive compensation disclosure to be presented separately for the principal executive officer, and as an average for the remaining NEOs identified in the Summary Compensation Table;
- Require the disclosure of the relationship between (1) executive compensation actually paid and registrant TSR (for the same executives identified in the registrant's Summary Compensation Table), and (2) registrant TSR and peer group TSR, in each case over the registrant's five most recently completed fiscal years;
- For smaller reporting companies, require the disclosure of the relationship between executive compensation actually paid and TSR over the registrant's three most recently completed fiscal years, without requiring these companies to provide disclosure of peer group TSR;
- Require that the disclosure be provided in tagged data format using eXtensible Business Reporting Language (XBRL); and
- Provide a phase-in of the requirement.

229.402(a)(6)]. Similarly, while we do not define the term "defined benefit and actuarial pension plans," the term has the same meaning as in Item 402 of Regulation S-K.

We discuss each of these aspects of our proposal in detail below.

Foreign private issuers, as defined in Exchange Act Rule 3b-4 [17 CFR 240.3b-4], would not be subject to the proposed amendment. Because securities registered by a foreign private issuer are not subject to the proxy statement requirements of Exchange Act Section 14,[25] foreign private issuers would not be required to provide Item 402(v) disclosure. As proposed, registered investment companies would not be required to provide Item 402(v) disclosure. We believe that the management structure of, and the regulatory regime governing, registered investment companies differentiate them from issuers that are operating companies. Registered investment companies, unlike other issuers, are generally externally managed and often have few, if any, employees that are compensated by the registered investment company. Rather, such employees are generally compensated by the registered investment company's investment adviser. Furthermore, registered investment companies do not have named executive officers within the meaning of Item 402, and, therefore, are not required to conduct the shareholder advisory votes required by Exchange Act Section 14A.[26] Business development companies are a category of closed-end investment company that are not registered under the Investment Company Act [15 U.S.C. 80a-2(a)(48) and 80a-53-64].

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25 Exchange Act Rule 3a12-3(b) [17 CFR 240.3a12-3(b)] specifically exempts securities registered by a foreign private issuer from Exchange Act Sections 14(a) and 14(c).

26 As noted earlier, we believe that the pay-versus-performance disclosure mandated by Section 953(a), together with the disclosure of the ratio of the median annual total compensation of employees to the annual total compensation of the chief executive officer mandated by Section 953(b), are intended to provide shareholders with information that will help them assess a registrant's executive compensation when they are exercising their rights to cast advisory votes on executive compensation under Exchange Act Section 14A. Further, as noted earlier, the Senate Report indicated that "a significant concern of shareholders is the relationship between executive pay and a company's financial performance," and that the pay-versus-performance disclosure would "add to corporate responsibility as firms will have to more clearly disclose and explain executive pay." *See* Senate Report, *supra* note 7.

As proposed, business development companies would be treated in the same manner as issuers other than registered investment companies and, therefore, would be subject to the disclosure requirement of Item 402(v).

B. New Item 402(v) of Regulation S-K

1. Application and Operation of Proposed Item 402(v)

Section 14(i) of the Exchange Act requires disclosure of the relationship of executive compensation actually paid and the financial performance of the registrant. Section 14(i) explicitly refers to Item 402 of Regulation S-K as the reference point for the executive compensation to be addressed by the new disclosure relating compensation to performance. Because the disclosure mandated by Section 14(i) relates specifically to executive compensation, we are proposing to require this new disclosure in a new Item 402(v) of Regulation S-K.

We are also proposing that the disclosure called for under new Item 402(v) of Regulation S-K be included in any proxy or information statement for which disclosure under Item 402 of Regulation S-K is required. Currently, Item 8 of Schedule 14A[27] and Item 1 of Schedule 14C[28] require registrants to furnish Item 402 information if action is to be taken with regard to: the election of directors; any bonus, profit sharing or other contract or arrangement in which any director, nominee or executive officer of the registrant will participate; any pension or retirement plan in which they will participate;

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[27] 17 CFR 240.14a-101.

[28] Schedule 14C [17 CFR 240.14c-101] works in conjunction with Schedule 14A to generally require the disclosure of information called for by Schedule 14A to the extent that the item would be applicable to any matter to be acted on at a meeting if proxies were to be solicited. Schedule 14C implements Exchange Act Section 14(c) [15 U.S.C. 78n(c)] which created disclosure obligations for registrants that choose not to, or otherwise do not, solicit proxies, consents, or other authorizations from some or all of their security holders entitled to vote.

or the granting or extension to them of options, warrants or rights to purchase securities on a pro rata basis.[29] By including the requirement in Item 402 and requiring this disclosure in proxy statements on Schedule 14A and in information statements on Schedule 14C,[30] shareholders would have available the pay-versus-performance disclosure, along with all other executive compensation disclosures called for by Item 402, in circumstances in which shareholder action is to be taken with regard to an election of directors or executive compensation. Because the proposed pay-versus-performance disclosure would be provided pursuant to Item 402 of Regulation S-K, it would be subject to the say-on-pay advisory vote under Exchange Act Rule 14a-21(a).[31]

We note that the language of Section 14(i) requires that the pay-versus-performance disclosure be provided "in any proxy or consent solicitation material for an annual meeting of the shareholders." Shareholder annual meetings are typically the venue in which directors are elected.[32] This statutory language, if construed narrowly,

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[29] The executive compensation disclosure called for under Item 402 of Regulation S-K is also required in certain registration statements under the Securities Act and the Exchange Act, as well as in annual reports on Form 10-K. Most registrants satisfy the Form 10-K disclosure requirement by incorporating by reference the information contained in their annual proxy or information statement.

[30] Even though Section 14(i) does not expressly include information statements provided for under Section 14(c), we believe that the purpose of information statements under Section 14(c), which established disclosure obligations for registrants that do not solicit proxies, does not support excluding the disclosure from information statements. Although Section 14(c) and Schedule 14C concern the provision of certain information when no solicitation is involved, Section 14(c) provides an obligation relating to information statements to transmit to holders "such security information substantially equivalent to the information which would be required to be transmitted if a solicitation were made…." 15 U.S.C. 78n(c).

[31] 17 CFR 240.14a-21.

[32] The Commission has previously recognized that directors ordinarily are elected at annual meetings. *See, e.g.*, Exchange Act Rule 14a-6(a) [17 CFR 240.14a-6(a)] (acknowledging that registrants soliciting proxies in the context of an election of directors at an annual meeting may be eligible to rely on the exclusion from the requirement to file a proxy statement in preliminary form). *See also*, Exchange Act Rule 14a-3(b) [17 CFR 240.14a-3(b)] (requiring proxy statements used in connection with the election of directors at an annual meeting to be preceded or

would require the pay-versus-performance disclosure in different instances than our rules currently require for other executive compensation disclosure.[33] In particular, under our current rules if a registrant solicits proxies[34] with respect to the election of directors or executive compensation matters, its proxy statement must include specified information required by Item 402 of Regulation S-K, whether the election takes place at an annual or special meeting.[35] We believe Item 402 disclosure, including the disclosure that would

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accompanied by an annual report containing audited financial statements). The requirement for registrants to hold an annual meeting at which directors are to be elected, however, is imposed by a source of legal authority other than the federal securities laws. In Delaware, for example, where more than 50% of the publicly traded issuers are incorporated, according to the State of Delaware's official website, Delaware General Corporation Law (DGCL), Section 211(b) is viewed as requiring an annual meeting for the election of directors. *See* R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS, §7.1 (3d ed.), EDWARD P. WELCH, ANDREW J. TUREZYN, & ROBERT S. SAUNDERS, FOLK ON THE DELAWARE GENERAL CORPORATE LAW § 211.2 (2013), and the text of DGCL Section 211(b), which reads in relevant part, "unless directors are elected by written consent in lieu of an annual meeting as permitted by this subsection, an annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws." *See also* CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 167 (7th ed.) (explaining that the "paramount shareholder function is the election of directors" and that "[m]ost corporation codes protect this right by specifying immutably that directors shall be elected at an annually held meeting of shareholders."), California Corporations Code, Section 600(b), and 1969 Model Business Corporation Act (as amended through 1981), Section 7.01(a) (each requiring an annual meeting of shareholders for the election of directors).

33 The language of Section 14(i) calls for the disclosure to be provided in connection with annual meetings, the meeting at which registrants generally provide for the election of directors. Depending on the circumstances, this construction could be narrower or broader than the scope of Item 8 of Schedule 14A, which requires executive compensation disclosure in circumstances where action is to be taken with regard to an election of directors or executive compensation. For example, a registrant could solicit proxies to approve a management contract or arrangement or other compensation plan at a special meeting instead of an annual meeting and, in this instance, Item 8 would require Item 402 executive compensation disclosure. By contrast, although an annual meeting ordinarily involves an election of directors, in the unlikely event that an annual meeting did not include an election of directors or other executive compensation actions, the proposed amendment would not require any Item 402 executive compensation disclosure.

34 Rule 14a-1(f) [17 CFR 240.14a-1(f)] defines the term "proxy" to include every proxy, consent or authorization within the meaning of Section 14(a) of the Exchange Act. A solicitation of consents therefore constitutes a solicitation of proxies subject to Section 14(a) and Regulation 14A.

35 *See* Item 8 of Schedule 14A.

be required under proposed Item 402(v), is equally useful to shareholders without regard to the venue of the corporate action.

Consistent with our approach to other Item 402 disclosures, we are proposing to require pay-versus-performance disclosure in these instances because we believe that the proposed disclosure would be most useful to shareholders when they are deciding whether to approve the compensation of the NEOs through the say-on-pay advisory vote, as well as when making voting decisions on a compensation plan in which NEOs participate, and making decisions pertaining to the election of directors. The Senate Report accompanying the statute references shareholder interest in the relationship between executive pay and performance as well as the general benefits of transparency of executive pay practices.[36] Several commenters also noted that the mandate may help inform shareholders.[37] For example, one commenter stated a belief that the requirements of Section 953(a), if implemented appropriately, "will help investors better understand the executive pay decisions of the company, and make more informed 'Say-on-Pay' votes."[38]

By proposing to require the disclosure as a new Item 402 requirement, however, the pay-versus-performance disclosure, unless otherwise limited, also would be required in a registrant's Form 10-K and in Securities Act registration statements that require Item

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36 The Senate Report includes the following with respect to Section 953(a) of the Dodd-Frank Act: "It has become apparent that a significant concern of shareholders is the relationship between executive pay and the company's financial performance...The Committee believes that these disclosures will add to corporate responsibility as firms will have to more clearly disclose and explain executive pay." *See* Senate Report *supra* note 7.

37 *See* letters from American Federation of Labor and Congress of Industrial Organizations (Aug. 8, 2014) ("AFL-CIO"), PublicCitizen, ClearBridge and Pay Governance.

38 *See* letter from Pay Governance.

402 disclosure. The language of Section 14(i) calling for the disclosure to be provided in solicitation material for an annual meeting of the shareholders suggests that the disclosure was intended to be provided in conjunction with a shareholder vote, and we believe that the disclosure would be most useful in this context. Therefore, we are proposing that Item 402(v) specify that the disclosure would only be required in a registrant's proxy or information statement. In addition, as proposed, the information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.[39]

2. Format and Location of Proposed Disclosure

Section 14(i) of the Exchange Act requires us to adopt rules requiring disclosure of "information" that shows the relationship between executive compensation actually paid and registrant financial performance, but it does not specify the format or location of that disclosure.

We are not proposing a specific location within the proxy statement or information statement for this new disclosure. We note that the proposed disclosure item is related to the CD&A because it would show the historical relationship between executive pay and registrant financial performance, and may provide a useful point of comparison for the analysis provided in the CD&A. However, including this disclosure as part of CD&A might suggest that the registrant considered the pay-versus-performance relationship, as disclosed, in its compensation decisions, which may not be the case.

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39 *See* Instruction 6 to proposed Item 402(v) of Regulation S-K. As proposed, the information would therefore not be subject to forward incorporation by reference under Item 12(b) of Form S-3 [17 CFR 239.13].

Consequently, we believe it is appropriate to provide flexibility for registrants in determining where in the proxy or information statement to provide the disclosure required by proposed Item 402(v), although we generally expect registrants would disclose it with the Item 402 executive compensation disclosure.

As proposed, Item 402(v) would require registrants to provide a table containing the values of the prescribed measures of executive compensation actually paid, TSR for the registrant and TSR for the selected peer group (see table below). For each amount disclosed as executive compensation actually paid in columns (c) and (e) of the prescribed table, proposed Item 402(v) would require footnote disclosure for both principal executive officer compensation and average NEO compensation of each amount deducted from, and added to the total compensation amount as provided in the Summary Compensation Table. As proposed, Item 402(v) also would require registrants to include in the table the total PEO compensation reported in the Summary Compensation Table (column (b), and, for NEOs, the average total compensation reported in the Summary Compensation Table (column (d)). Requiring disclosure of the Summary Compensation Table measure of total compensation together with our proposed measure of executive compensation actually paid would provide shareholders with disclosure of two measures in one single table and, we believe, would facilitate comparisons of the two measures of a registrant's executive compensation to the registrant's performance. To the extent that some shareholders may be interested in considering the relationship of performance with a measure of pay that excludes changes in the value of equity awards, they would be able to refer to the Summary Compensation Table measure of total compensation required alongside executive compensation actually paid in the tabular disclosure. Among other things, the Summary Compensation Table measure of total compensation reflects the grant date values of equity awards.

We are proposing that the disclosure provided in each column of the proposed table, including any footnote disclosure, be provided in interactive data format using XBRL.[40] The proposal would require registrants to tag separately the values disclosed in the required table, and to separately block-text tag the disclosure of the relationship among the measures, the footnote disclosure of deductions and additions used to determine executive compensation actually paid, and the footnote disclosure regarding vesting date valuation assumptions. The interactive data would have to be provided as an exhibit to the definitive proxy or information statement filed with the Commission, in addition to appearing with and in the same format as the rest of the disclosure provided pursuant to proposed Item 402(v) of Regulation S-K (*e.g.*, in ASCII or HTML). Registrants would be required to prepare their interactive data using the list of tags the Commission specifies and submit them with any supporting files the EDGAR Filer Manual prescribes.[41] We believe requiring the data to be tagged would lower the cost to investors of collecting this information, would permit data to be analyzed more quickly by investors and other end-users than if the data was provided in a non-machine readable format, and would facilitate comparisons among public companies. In addition, requiring the data to be tagged would facilitate analysis of how information related to a single issuer changes over time.

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40 Data becomes interactive when it is labeled or "tagged" using a computer markup language such as XBRL that software can process for analysis.

41 The EDGAR Filer Manual is available at: http://www.sec.gov/info/edgar/edmanuals.htm.

PAY VERSUS PERFORMANCE

Year (a)	Summary Compensation Table Total For PEO (b)	Compensation Actually Paid to PEO (c)	Average Summary Compensation Table Total for non-PEO Named Executive Officers (d)	Average Compensation Actually Paid to non-PEO Named Executive Officers (e)	Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)

Because the statute requires disclosure of the *relationship* between executive compensation and registrant performance, we do not believe that simply disclosing the amount of executive compensation actually paid and the financial performance measure would satisfy this statutory requirement. Thus, using the values presented in the table, proposed Item 402(v) would require the registrant to describe (1) the relationship between the executive compensation actually paid and registrant TSR, and (2) the relationship between registrant TSR and peer group TSR. We believe disclosure about the relationship between registrant TSR and peer group TSR would provide information that investors can use to compare a registrant's performance with that of its peers, and may provide a useful point of comparison to assess the relationship between the registrant's executive compensation actually paid and its financial performance compared to the performance of its peers during the same time period.

The disclosure about the relationship would follow the table and could be described as a narrative, graphically, or a combination of the two, and, as proposed, would be required to be provided in interactive data format using XBRL. Disclosure of the relationship could include, for example, a graph providing executive compensation actually paid and change in TSR on parallel axes and plotting compensation and TSR over the required time period. Alternatively, disclosure of the relationship could include showing the percentage change over each year of the required time period in both executive compensation actually paid and TSR together with a brief discussion of that relationship. Under our proposed amendments, while the presentation format used by different registrants to demonstrate the relationship between executive compensation actually paid and TSR may vary, the table required by Item 402(v) together with existing disclosures would provide shareholders with clear information from which to determine the relationship between executive compensation actually paid and registrant performance so that shareholders could, if desired, compare the disclosure across registrants.

Exchange Act Section 14(i) provides that the disclosure about the relationship may include a graphic representation of the information. Commenters provided varying views on whether to require a graphic presentation. Some commenters indicated that a graphic representation would help provide meaningful disclosure,[42] while other commenters supported a principles-based approach that would not include a specific requirement for a graphic representation.[43] Consistent with the language of Exchange Act Section 14(i), we are proposing to permit, rather than require, a registrant to comply with the new requirement to disclose the relationship between executive compensation

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42 *See* letters from Farient, Meridian and Shareholder Value Advisors, Inc. (Apr. 27, 2012) ("SVA II").

43 *See* letters from ABA, CEC I, and Davis Polk.

actually paid and registrant performance by including a graphic presentation of the pay-versus-performance disclosure, in addition to the required table presenting the values of prescribed measures of executive compensation and TSR.

Request for Comment

1. Exchange Act Section 14(i) specifies that the pay-versus-performance disclosure must be provided in any proxy or consent solicitation materials that relate to annual shareholder meetings. For the reasons discussed above, we are proposing to require the disclosure in a registrant's proxy or information statement where Item 402 disclosure is required. Should we instead, or in addition, require the disclosure in any proxy or information statements relating to an annual shareholder meeting (or special meeting or written consent in lieu of a meeting)? Why or why not?
2. To retain consistency in the executive compensation disclosure provided in proxy statements and information statements, we propose that the Item 402(v) disclosure be included in information statements on Schedule 14C as well as proxy statements on Schedule 14A for which Item 402 disclosure is required. Is there any reason that the proposed disclosure mandated by Section 14(i) should be limited to registrants that are soliciting proxies or consents on Schedule 14A?
3. Should we also require the proposed disclosure in all other forms and schedules in which executive compensation disclosure is required? Would it be useful to shareholders to include the proposed disclosure in registration statements or annual reports as well? Why or why not?

4. Should the disclosure required by Exchange Act Section 14(i) be a separate requirement under Item 402 of Regulation S-K, as proposed? Alternatively, should we require the disclosure as part of the CD&A? If so, please explain why.
5. Should we require registrants to provide, as proposed, a table that includes the Summary Compensation Table total compensation, in addition to the values of the prescribed measures of executive compensation actually paid and registrant financial performance used for the pay-versus-performance disclosure? Why or why not?
6. Should we further prescribe the format of the proposed disclosure to promote comparability across registrants? For example, should we require that registrants present the percentage change in executive compensation actually paid and registrant/peer group financial performance over each year of the required time period graphically or in writing? Are there other format requirements we should consider? Should we provide further guidance on how to present the information in a way that promotes comparability? Are there ways our proposed table can be improved?
7. If we were to require a graphic presentation of the disclosure, should we specify requirements for this presentation so that each registrant provides comparable disclosure? Or should we allow registrants to determine the appropriate graphic presentation, if any? How should such a graph describe the relationship between executive compensation actually paid and registrant performance?
8. Should we provide sample charts or other examples of graphic presentations that would comply with proposed Item 402(v)? If so, please provide examples.

9. Would requiring disclosure of the values of the prescribed measures of executive compensation actually paid and registrant financial performance, without additional information about the "relationship" of those data points, satisfy Section 14(i) of the Exchange Act?

10. Would the stock performance graph required by Item 201(e) of Regulation S-K modified to add a line representing executive compensation actually paid provide meaningful disclosure about the relationship between executive pay and registrant performance? Why or why not? If so, should we require the stock performance graph, as so modified to be included in the proxy or information statement as well as, or instead of, in the annual report to security holders required by Exchange Act Rules 14a-3 and 14c-3[44]? Would such disclosure satisfy Exchange Act Section 14(i)?

11. Under our current rules, unless specifically incorporated by reference, the disclosure required by Item 201(e) of Regulation S-K is not deemed to be "soliciting material" or to be "filed" with the Commission or subject to the liabilities of Exchange Act Section 18.[45] That same treatment is not afforded to the CD&A disclosure. Under the proposal, the pay-versus-performance disclosure, which would require disclosure of TSR as defined in Item 201(e) for the registrant and for a peer group used by the registrant for purposes of the CD&A or Item 201(e), would be filed in certain proxy or information statements. Should the disclosure about TSR be deemed to be filed, as proposed? Why or

44 17 CFR 240.14a-3 and 17 CFR 240.14c-3.

45 15 U.S.C. 78r; *see* Instruction 8 to Item 201(e) of Regulation S-K.

why not? Alternatively, should the TSR disclosure be deemed to be "furnished"? If the disclosure was treated as "furnished", should such treatment only apply to peer group TSR? Why or why not?

12. Would the proposed tabular disclosure of the values of the executive compensation and registrant financial performance enhance comparability across registrants? Are there other formats that would be more useful in that regard?

13. Should we require that the data be tagged in XBRL format, as proposed? Should we require a different format, such as, for example, eXtensible Markup Language (XML)?[46] Should the proposed tabular disclosure be changed in any way to facilitate accurate and consistent tagging? If so, how? Should we require that, as proposed, disclosure about the relationship between executive compensation and registrant performance be tagged? Why or why not? Would tagging the relationship of executive compensation to financial performance enhance comparability among different registrants? Alternatively, instead of requiring that the disclosure about the relationship be tagged, should tagging this disclosure be optional? If a registrant chooses to add more information to the prescribed table, should we require this additional information to be tagged as well, even if registrant-specific extensions are necessary?

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46 Another possible alternative for providing the information in interactive data format would be Inline XBRL, which would allow registrants to file the required information and data tags in one document rather than requiring a separate exhibit for the interactive data. Commission rules and the EDGAR system do not currently allow for the use of Inline XBRL. To the extent that a determination is made in the future to accept Inline XBRL submissions, we expect to revisit the format in which this disclosure requirement is provided.

14. Should we require that the data be tagged in preliminary proxy statements and information statements, as well as in definitive proxy statements and information statements? Why or why not?

15. Should we exempt smaller reporting companies from the XBRL requirement, rather than require them to provide such data? Why or why not? Would the costs be different for smaller reporting companies to comply with the proposed requirement to provide the data in XBRL format as compared to other companies? What would be the impact of not requiring tagging for smaller reporting companies? Should we, as proposed, provide a phase-in for smaller reporting companies to tag the disclosure? Why or why not? Should the period be longer or shorter than three years?

16. Instruction 1 to Item 402(c)(2)(iii) and (iv) of Regulation S-K permits a registrant to omit disclosure in the Summary Compensation Table of the salary or bonus of an NEO if it is not calculable as of the latest practicable date.[47] Item 5.02(f) of Form 8-K[48] sets forth the requirements for the filing of information that was omitted from Item 402 disclosure in accordance with Instruction 1 to Item 402(c)(2)(iii) and (iv), including the requirement to include a new total compensation figure for the NEO. Should we consider permitting registrants to omit pay-versus-performance disclosure until those elements of the NEO's total compensation are determined and to provide the pay-versus-performance disclosure in the same filing under Item 5.02(f) of Form 8-K in which the salary

[47] For smaller reporting companies, Instruction 1 to Item 402(n)(2)(iii) and (iv) is the corresponding instruction.

[48] 17 CFR 249.308.

or bonus is disclosed? Is such relief necessary given that, as proposed, registrants will not be required to incorporate the disclosure into the Form 10-K? If we were to provide the relief, should we require any additional or supplemental disclosure in connection with an amendment to Item 5.02(f)? If so, what would that disclosure entail?

C. Executives Covered

Exchange Act Section 14(i) does not specify which executives must be included in the disclosure of "executive compensation actually paid." For registrants other than smaller reporting companies, we are proposing that the executives covered by the proposed Item 402(v) disclosure be the "named executive officers" as defined in Item 402(a)(3) of Regulation S-K.[49] For smaller reporting companies, we are proposing that the executives covered by the proposed Item 402(v) disclosure be the same as the "named executive officers" required to be disclosed under Item 402(m).[50] These are the executive

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49 Item 402(a)(3) [17 CFR 229.402(a)(3)] defines the NEOs for whom Item 402 executive compensation is required as 1) all individuals serving as the registrant's principal executive officer or acting in a similar capacity during the last completed fiscal year ("PEO"), regardless of compensation level, 2) all individuals serving as the registrant's principal financial officer or acting in a similar capacity during the last completed fiscal year ("PFO"), regardless of compensation level, 3) the registrant's three most highly compensated executive officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year, and 4) up to two additional individuals for whom Item 402 disclosure would have been provided but for the fact that the individual was not serving as an executive officer of the registrant at the end of the last completed fiscal year. Because the pay-versus-performance disclosure is being proposed as new paragraph (v) to Item 402, the disclosure also would be required for the NEOs.

50 For smaller reporting companies, Item 402(m)(2) [17 CFR 229.402(m)(2)] defines the NEOs for whom Item 402 executive compensation is required as 1) all individuals serving as the smaller reporting company's principal executive officer or acting in a similar capacity during the last completed fiscal year (PEO), regardless of compensation level, 2) the smaller reporting company's two most highly compensated executive officers other than the PEO who were serving as executive officers at the end of the last completed fiscal year, and 3) up to two additional individuals for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer of the smaller reporting company at the end of the last completed fiscal year.

officers for whom, under our current rules, compensation disclosure is required in the Summary Compensation Table and the other executive compensation disclosure requirements. In addition, we are proposing that, for each year, the compensation information be presented separately for the principal executive officer[51] and as an average for the remaining NEOs identified in the Summary Compensation Table.

We note that Section 14(i) specifically refers to compensation required to be disclosed under Item 402 of Regulation S-K. Because Item 402 of Regulation S-K requires disclosure of NEO compensation, we believe that Congress intended for the rules to provide disclosure about that group. We also believe that covering only the NEOs should help to mitigate some of the costs associated with the proposed disclosure because registrants are already required to make the determination of who is an NEO and to track information about their compensation. Commenters that addressed this issue were generally supportive of requiring that the pay-versus-performance disclosure cover the NEOs.[52]

We are proposing to require that the disclosure be provided separately for the PEO and as an average for the remaining NEOs identified in the Summary Compensation Table. Several commenters noted that shareholders have a particular interest in the compensation of the PEO.[53] We are further proposing that if more than one person

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51 The term "principal executive officer" used in this release has the same meaning as in Items 402(a)(3) and 402(m)(2) of Regulation S-K and would include an individual acting in a similar capacity.

52 *See* letters from ABA, Baker, Donelson, Bearman, Caldwell & Berkowitz ("Baker Donelson"), ClearBridge, Compensia, Brian Foley & Company ("Foley") and MDU.

53 *See* letters from Farient, Johnson & Johnson ("J&J"), Meridian and Pay Governance. One such commenter recommended that we limit the disclosure solely to the PEO. *See* letter from Meridian. As discussed above, however, because Section 14(i) specifically refers to compensation required

served as the PEO of the registrant, then the disclosure for the persons who served as PEO of the registrant shall be aggregated for the years in which more than one person served as the PEO because this reflects the total amount that was paid by the registrant for the services of a PEO.

Finally, we are proposing to require disclosure of the average compensation actually paid for the remaining NEOs. We believe disclosure of the relationship of performance to average NEO compensation would be more meaningful to shareholders than individual or aggregate NEO compensation. There can be significant variability in the identity of the registrant's other NEOs over a five-year period. Moreover, the number of NEOs for whom Item 402 disclosure is required may fluctuate from year-to-year, which would make an aggregate total not comparable year over year.[54] We believe requiring disclosure of the average compensation would help make the information about these NEOs more comparable from year to year in spite of the variability in the composition and number of NEOs who are not the PEO over the years for which disclosure is required.

Request for Comment

17. Should we require that the proposed disclosure cover the NEOs as defined in Item 402(a)(3) of Regulation S-K, or Item 402(m) for smaller reporting companies, as proposed? Alternatively, should we require disclosure for a different group of

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to be disclosed under Item 402, and Item 402 applies to a broader group of NEOs than the PEO, we believe the disclosure should be required about that group.

54 For example, in any year, up to two additional individuals who were not serving as executive officers at the end of the year must be included if they otherwise would have been among the most highly compensated. Additionally, for registrants other than smaller reporting companies, if more than one person serves as principal financial officer during the year, each of them must be included in the Summary Compensation Table.

executives than the NEOs and, if so, how should such a group be defined? For example, would the appropriate group be all executive officers as defined in Rule 3b-7 under the Exchange Act?[55] What additional costs would registrants incur if they were required to provide information for executives not currently defined as NEOs?

18. Should we require registrants to provide the pay-versus-performance disclosure for NEOs other than the PEO as an average, as proposed, or should we specify that the disclosure must be made either in the aggregate (*i.e.*, the sum of all other NEOs' compensation) or on an individual basis for each NEO? How would these approaches affect, either positively or negatively, the comparability across registrants? Alternatively, should registrants provide tabular disclosure of the executive compensation actually paid on an individual basis for each NEO but only be required to demonstrate the relationship to financial performance for the PEO's individual compensation and the average compensation of the other NEOs? Are there ways other than using an average for the other NEOs to appropriately account for the possibility that the size and identity of the group of other NEOs could change each year? What impact would changes to the group of other NEOs have on the comparability and usefulness of pay-versus-performance disclosure?

19. Should we require separate disclosure for the PEO, as proposed? Should we require, in instances where a registrant had more than one PEO in a given year, that the amounts for each PEO be added together, as proposed? Under our

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[55] 17 CFR 240.3b-7.

executive compensation disclosure rules, if an individual served in the capacity of PEO during any part of a fiscal year for which executive compensation disclosure is required, information about the individual's compensation for the full fiscal year is required to be disclosed. Should the compensation amount for the pay-versus-performance disclosure include only compensation received as the PEO? Should we require separate disclosure for each individual who served as a PEO during the required time period of disclosure? Are there alternative approaches we should consider? For example, where a registrant had more than one PEO in a given year, should we permit registrants the flexibility to choose instead to annualize the compensation of the PEO serving at the end of the fiscal year?

20. Should we require disclosure for only the PEO? Would information about the non-PEO NEOs be meaningful or useful for investors? Would information about the PEO's compensation provide adequate information to investors about the pay-versus-performance alignment of other NEOs? Would limiting the scope of disclosure to the PEO result in meaningful cost savings to registrants, for example by limiting the extent to which they must perform recalculations of compensation actually paid (see Section II.D below) or average calculations? Would limiting the disclosure to the PEO affect the usefulness of the information for investors?

D. Determination of "Executive Compensation Actually Paid"

Exchange Act Section 14(i) does not define the phrase "executive compensation actually paid," but it does require a "clear description of any compensation required to be disclosed by the registrant" under Item 402 of Regulation S-K.[56] We are proposing that

[56] 15 U.S.C. 78n(i).

"executive compensation actually paid" under proposed Item 402(v) of Regulation S-K would be total compensation as reported in the Summary Compensation Table,[57] modified to adjust the amounts included for pension benefits and equity awards. We believe using as a starting point the total compensation that registrants already are required to report in the Summary Compensation Table and making adjustments to those figures reduces burdens to registrants and also may enhance comparability of the proposed disclosure across registrants.[58]

Although Exchange Act Section 14(i) refers to compensation required to be disclosed under Item 402 of Regulation S-K, it also uses the phrase "actually paid," which differs from disclosure required under Item 402 of "compensation awarded to, earned by or paid to" the NEOs.[59] We believe that Congress intended executive compensation "actually paid" to be an amount distinct from the total compensation as reported under Item 402 because it used a term not otherwise referenced in Item 402. As such, we believe that adjustments to some of the elements in the Summary Compensation Table are appropriate to reflect executive compensation that is "actually paid" within the meaning of Section 14(i). Total compensation as reported in the Summary Compensation Table is the appropriate starting point and, as proposed, would be included in the table as discussed above, but registrants would need to adjust some elements of compensation

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57 Item 402(c) of Regulation S-K. Smaller reporting companies provide the scaled Summary Compensation Table disclosure specified in Item 402(n) of Regulation S-K.

58 We note that the pay ratio disclosure required by Section 953(b) of the Dodd-Frank Act is required to be based on total compensation as provided in the Summary Compensation Table. In light of the different language in Section 953(a), which references compensation that is "actually paid," we believe it is appropriate to adjust the treatment of certain components of total compensation for the disclosure required by Section 953(a) of the Dodd-Frank Act.

59 *See* 17 CFR 229.402(a)(2).

determined according to the Summary Compensation Table reporting requirements to reflect amounts "actually paid" to the NEOs.

Some commenters were of the view that we should not prescribe the specific compensation elements to be covered[60] or the method of determination of when equity awards are "actually paid."[61] Instead, these commenters suggested that registrants be permitted flexibility to determine which compensation elements should be included in pay-versus-performance disclosure.[62] While such an approach could benefit registrants by permitting them to determine the disclosure they believe best reflects the relationship between executive pay and the registrant's performance, we believe that such flexibility would limit comparability across registrants, making the disclosure less useful to shareholders.[63]

Other commenters recommended that we limit the compensation required to be disclosed for purposes of the pay-versus-performance disclosure to the amounts that are based on the financial performance of the company.[64] Some commenters supported particular definitions of "actually paid" covering specific compensation elements,[65] such as a measure including only the grant date fair value for all equity awards that are subject

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60 *See* letters from ABA, CEC I, ClearBridge and Davis Polk.

61 *See* letters from ABA, CEC I, Davis Polk, Protective Life and Society of Corporate Secretaries and Governance Professionals ("SCSGP").

62 *See* letters from ABA, CEC I and Davis Polk. One commenter stated that "[a]n issuer should be able to determine which compensation elements are based on performance and explain the rationale for why it included those elements in this analysis, and excluded others." *See* letter from Davis Polk.

63 *See, e.g.,* letters from AFL-CIO and Council of Institutional Investors ("CII").

64 *See* letters from Compensia and Center for Executive Compensation (Oct. 17, 2014) ("CEC II").

65 *See* letters from ClearBridge and Pay Governance. ClearBridge and Pay Governance recommended using particular definitions of realizable pay.

to performance-based vesting conditions and cash amounts awarded based on the financial performance of the registrant.[66] Some commenters suggested that change in pension value should be excluded from the Summary Compensation Table calculation in computing the new measure.[67] Other commenters, by contrast, recommended that the Commission define "executive compensation actually paid" as broadly as possible, regardless of whether a particular component of compensation is awarded based on performance.[68]

We are aware that a number of registrants have used the concepts of "realizable pay" and "realized pay" in their proxy statements as a means of comparing pay and performance.[69] While there continues to be work among various compensation constituencies to agree upon a consistent methodology for calculating "realizable pay" or "realized pay," we are not aware that there has yet been broad agreement upon any particular formula. Registrants may choose to supplement the disclosure required by proposed Item 402(v) by providing pay-versus-performance disclosure based on a measure of "realized pay," "realizable pay," or another appropriate measure if they believe it provides useful information about the relationship between compensation and

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66 *See* letter from Compensia.

67 *See* letters from Baker Donelson, Frederic W. Cook & Co., Inc. ("Cook"), and Meridian.

68 *See* letter from CII. *See also* letter AFL-CIO (recommending that the Commission require disclosure of all forms of compensation as disclosed in the Summary Compensation Table).

69 The concepts of "realized pay" and "realizable pay" are designed to provide different measures of alignment between a named executive officer's pay and performance, though there are no standard definitions of either term. Registrants can tailor the concepts resulting in amounts which generally differ from the amounts disclosed in the Summary Compensation Table because they exclude various types of compensation such as the value of unvested or unexercised equity awards. We note that some proxy advisory services have also begun to take into account some version of "realizable pay" or "realized pay" when making say-on-pay voting recommendations. *See, e.g.*, Institutional Shareholder Services, Inc., U.S. Corporate Governance Policy 2014 updates (Nov. 21, 2013).

registrant performance, provided that the supplemental disclosure is not misleading and not presented more prominently than the required disclosure.

Because the statute does not define "executive compensation actually paid," we are using our discretion to define that term for the purpose of proposed Item 402(v) disclosure.[70] As indicated above, while we believe the Summary Compensation Table is the appropriate starting point, we believe some adjustments are appropriate to give effect to the statutory language and reflect executive compensation that is "actually paid." Specifically, as discussed below, we propose to modify the amounts included for pension benefits and equity awards.[71] Moreover, we believe that the phrase "executive compensation actually paid" should include all compensation actually paid, regardless of whether the compensation is awarded based on the registrant's financial performance. In considering the relationship between executive compensation actually paid and the registrant's financial performance, we believe shareholders should be able to take into account components of compensation regardless of whether or not they are awarded based on the registrant's performance.

1. Changes in Actuarial Pension Value

We propose to deduct the change in the actuarial present value of all defined benefit and pension plans from the Summary Compensation Table total for purposes of proposed Item 402(v).[72] This Summary Compensation Table measure includes the

70 Proposed Item 402(v)(2).

71 These terms have the same definitions as in Item 402 of Regulation S-K.

72 The change in actuarial present value, generally, reflects the difference between the actuarial present value of accumulated benefits at the end of the fiscal year and at the end of the prior fiscal year. This amount would be deducted only if the value is positive, and therefore included in the sum reported in column (h) of the Summary Compensation Table. Where such amount is

change in actuarial present value of pension benefits previously accrued based on changes in interest rates, executive age, and other actuarial inputs and assumptions, which may introduce significant volatility into this measure, as well as the actuarial present value of accrued pension benefits earned by the executive based on an additional year of service.[73] Item 402(v) would require, however, that the actuarially determined service cost for services rendered by the executive during the applicable year be added back.[74] Thus, the portion of the total change in actuarial pension value that results solely from changes in interest rates, executive's age and other actuarial inputs and assumptions regarding benefits accrued in previous years would be excluded.

We believe that including only the service cost for services rendered by the executive during the applicable year is a more appropriate measure for purposes of determining compensation "actually paid" during the applicable year because it is limited to pension costs for benefits earned during that year. The amount we proposed to include may be viewed to approximate the value that would be set aside currently by the registrant to fund the pension benefits payable upon retirement for the service provided during the applicable year. We recognize that registrants may differ as to whether they

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negative, and therefore reported only in a footnote to column (h), it should not be reflected for purposes of proposed Item 402(v). *See* Instruction 3 to Item 402(c)(2)(viii). Smaller reporting companies would not need to deduct this amount because the Summary Compensation Table requirements for smaller reporting companies do not require disclosure of the change in actuarial present value.

73 While commenters were divided on which elements of compensation should be included, some commenters supported calculating compensation by excluding changes in pension value and above-market earnings on deferred compensation from the compensation in the Summary Compensation Table. *See* letters from Meridian, Baker Donelson, and Cook.

74 Service cost is defined in FASB ASC Topic 715 as the actuarial present value of benefits attributed by the pension plan's benefit formula to services rendered by the employee during the period. The measurement of service cost reflects certain assumptions, including future compensation levels to the extent provided by the pension plan's benefit formula.

use defined benefit or defined contribution retirement plans, and this proposed change to the amount disclosed in the Summary Compensation Table is intended to provide a more meaningful comparison across registrants of the amounts "actually paid" under both types of plan. For defined contribution plans, the Summary Compensation Table requires disclosure of registrant contributions or other allocations to vested and unvested defined contribution plans for the applicable fiscal year,[75] which will also be included in computing compensation actually paid for purposes of the new disclosure.

We do not expect that the proposed adjustments will require the collection of significant new data by registrants, or reveal significant new information to shareholders relative to the compensation disclosure that is currently required. The pension's annual service cost is not required to be reported separately, but can be calculated based on information reported in, and in footnotes to, the Pension Benefits Table. We believe that, for purposes of proposed Item 402(v), using the actuarially determined service cost rather than the Summary Compensation Table pension measure may increase comparability of compensation provided through defined benefit and defined contribution plans because of the variability of the actuarial inputs and assumptions among different registrants.

2. Earnings on Non-Qualified Deferred Compensation

Consistent with the current disclosure requirements of the Summary Compensation Table, the compensation calculation under proposed Item 402(v) would include above-market or preferential earnings on deferred compensation that is not tax-qualified because these amounts represent compensation accrued during the relevant

[75] Item 402(c)(2)(ix)(E).

year.[76] Above-market or preferential earnings on deferred compensation represent amounts accrued during the year based on the registrant's compensatory decision to pay an above-market return. Excluding this element from disclosure of compensation "actually paid" until its eventual payout would make disclosure contingent on an NEO's decision to withdraw or take a distribution from his or her account, rather than the registrant's compensatory decision to pay the above-market return. Such an approach would be inconsistent with the Summary Compensation Table disclosure of the underlying deferred amounts when earned,[77] which we would carry forward to proposed Item 402(v), and could result in the relationship of this amount to company performance never being disclosed.

3. Equity Awards

We are proposing that equity awards be considered actually paid on the date of vesting and valued at fair value on that date, rather than fair value on the date of grant as required in the Summary Compensation Table.[78] Before vesting, an executive does not

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76 These earnings are reported pursuant to Item 402(c)(2)(vii), or, for smaller reporting companies, Item 402(n)(2)(viii). These earnings, like the aggregate change in defined benefit plan actuarial present value also reported pursuant to Item 402(c)(2)(viii), or Item 402(n)(2)(viii), are excluded for purposes of a registrant's NEO determination pursuant to Instruction 1 to Item 402(a)(3), or, for smaller reporting companies, Instruction 1 to Item 402(n)(2)(viii). In adopting this Instruction, the Commission stated it was appropriate to exclude these items because their amounts generally are not determined by the Compensation Committee. Rather, they are "compensation elements that principally reflect executives' decisions to defer compensation and wealth accumulation in pension plans, or are unduly influenced by age or years of service." *See Executive Compensation and Related Person Disclosure*, Release 33-8732A (Aug. 29, 2006) [71 FR 53158 (Sept. 8, 2006)], at Section II.C.6 ("Executive Compensation Release"). These reasons, however, do not seem relevant to a determination of whether such compensation is "actually paid" for purposes of the disclosure mandated by Section 14(i).

77 Instruction 4 to Item 402(c), or, for small reporting companies, Instruction 4 to Item 402(n).

78 Grant date fair value disclosure reflects compensation committee decisions during the relevant fiscal year relating to equity awards. *See Proxy Disclosure Enhancements*, Release No. 33-9089 (Dec. 16, 2009) at Section II.A.2 [74 FR 68334] (Dec. 23, 2009).

have an unconditional right to an equity award. For example, the terms of both options and restricted stock awards typically provide for forfeiture of the award if the executive leaves the registrant's employment before the vesting date or if specified performance criteria are not met. Accordingly, we do not believe that an option or other equity award should be considered "actually paid" for purposes of this disclosure before the applicable vesting conditions are satisfied. Satisfaction of these conditions, which are determined by the registrant, can be viewed as representing payment by the registrant. Moreover, using vesting-date valuations will result in a compensation measure that includes, upon the vesting date, the grant-date value of equity awards plus or minus any change in the value of equity awards between the grant and vesting date. Such changes in the value of equity grants after the grant date represent a direct channel, and one of the primary means, through which pay is linked to registrant performance.

We do not believe that an award requiring exercise should be considered actually paid only upon its exercise, because once the award is vested the executive can control how and when the award is monetized, and thus could influence pay-versus-performance disclosure by controlling the fiscal year in which the executive receives the compensation. Changes in the fair value of the award after vesting generally reflect investment decisions made by the executive rather than compensation decisions made by the registrant.

The value of stock awards upon vesting is disclosed in the Option Exercises and Stock Vested Table.[79] Registrants are not currently required to report the value of option awards upon vesting if they are not exercised. However, registrants can apply existing

[79] *See* Item 402(g)(2)(v). Smaller reporting companies are not required to provide this table.

models and methodologies to compute these values. Also, it is possible for shareholders to make reasonable estimates of these vesting-date fair values of options based on current disclosures.

In particular, the terms of unexercised option awards in a given year, including their exercise prices and expiration dates, are required to be disclosed (together with information about other outstanding awards) in the Outstanding Equity Awards at Fiscal Year-End Table.[80] Information about the valuation assumptions used by the registrant to calculate the grant-date value of option awards can be found in footnotes to the Summary Compensation Table (which may refer to disclosures made on Form 10-K) for the year corresponding to the grant date.[81] Disclosures about the vesting conditions that applied to the awards can be used to determine which of the option awards are newly vested.[82] The translation of the reported terms of these options into their fair values at vesting requires the choice of a valuation methodology and the use of public data and reasonable

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[80] *See* Item 402(f)(2)(v) and (vi). For smaller reporting companies, see Item 402(p)(2)(v) and (vi). Some options may be exercised in the same year as vesting. Whether an option award that was exercised had vested in the same year can be determined by comparing the Outstanding Equity Awards at Fiscal Year-End Table per Item 402(f) or, for smaller reporting companies, Item 402(p), to the same table for the prior year, and identifying as exercised options those that are no longer reported as outstanding. In such cases, the terms of these awards can be determined from the Outstanding Equity Awards at Fiscal Year-End Table and related footnotes for the prior year or, for options granted in the same year as exercise (which will not appear in disclosures for the prior year) in footnotes to the Summary Compensation Table for the same year.

[81] *See* Instruction 1 to Item 402(c)(2)(v) and (vi). For smaller reporting companies, *see* Instruction 1 to Item 402(n)(2)(v) and (vi).

[82] Registrants are required to describe the material conditions of awards, including a general description of the formula or criteria to be applied in determining the amounts payable, and the vesting schedule, in the narrative disclosure to the Summary Compensation Table and Grants of Plan-Based Awards table per Item 402(e) in the year in which an option award is granted. Smaller reporting companies are required to describe the material conditions of awards in the narrative disclosure to the Summary Compensation Table per Item 402(o) in the year in which an option award is granted. The vesting date of options held at fiscal-year end must be disclosed by footnote to the Outstanding Equity Awards at Fiscal-Year End table required by Item 402(f), or, for smaller reporting companies, Item 402(p), of Regulation S-K.

assumptions (potentially with reference to the registrant's disclosed grant-date valuation assumptions) to obtain the additional inputs required for option valuation at vesting date. Estimates thus computed by shareholders could differ from estimates computed by the registrant and, as mentioned above, current disclosure rules do not require registrants to compute and disclose their own estimates of these values.

Accordingly, for purposes of proposed Item 402(v), the amounts reported pursuant to Items 402(c)(2)(v) and (vi) would be subtracted from total compensation reported in the Summary Compensation Table, and the following would be added in their place:[83]

- For awards of stock, that vested in the applicable year, the fair value at vesting date, computed in accordance with the fair value guidance in FASB ASC Topic 718; and
- For awards of options with or without tandem stock appreciation rights ("SARs") that vested in the applicable year, the fair value at vesting date, computed in accordance with the fair value guidance in FASB ASC Topic 718. As proposed, a registrant would be required to disclose vesting date valuation assumptions if they are materially different from those disclosed in its financial statements as of the grant date.

83 Proposed Item 402(v)(3) would require registrants to disclose in a footnote to the table required under paragraph (v)(1), the total compensation amount reported in the Summary Compensation Table for the covered fiscal year for each NEO as provided in paragraph (c)(2)(x), or, for smaller reporting companies, paragraph (n)(2)(x), and the individual amounts deducted from, and modifications to, the amounts reported in the Summary Compensation Table in generating the amounts disclosed pursuant to Item 402(v) for the PEO(s). For NEOs other than the PEO, proposed Item 402(v)(3) would require disclosure of these amounts as averages.

We believe shareholders may be interested in vesting date valuation assumptions to the extent they believe that changes in the value of equity grants after the grant date are a primary channel through which pay is linked to performance. We believe that requiring disclosure of vesting date valuation assumptions would make these computations readily accessible to shareholders, which may be useful to shareholders to the extent they are interested in computing slightly different measures or using parts of the computations for other purposes. Further, if during the last completed fiscal year the registrant adjusted or amended the exercise price of previously vested options or SARs held by an NEO, whether through amendment, cancellation or replacement grants, or any other means, or otherwise has materially modified such awards, proposed Item 402(v) would require the registrant to include the incremental fair value, computed as the excess fair value of the modified award over the fair value of the original award upon vesting of the modified award. If the modified award is subject to multiple vesting dates, the pro rata incremental fair value would be determined and included in compensation actually paid at each vesting date.

For example, a registrant grants an option ("original award") for 1,000 shares of common stock with an exercise price of $20 per share. By its terms, the original award vests upon completion of a two-year service period. Upon vesting, the then fair value of the original award is included in compensation actually paid. After the original award vests, assume the registrant modifies its terms to reduce the exercise price to $15 per share with 50% vesting immediately and 50% vesting upon completion of another two-year service period ("modified award"). The incremental fair value that is included in compensation actually paid will be computed at each of the modified award's two vesting dates based on the then excess fair value of the ratable 500 shares using the modified award terms compared with the original award terms. In this example, compensation actually paid would be determined three times, as the full fair value of the original award at its vesting and the pro rata incremental fair value amounts at each of the two vesting dates of the modified award.[84]

Request for Comment

21. Does our proposed definition appropriately capture the concept of "executive compensation actually paid?" Why or why not? Are there elements of compensation excluded by our proposed definition that should not be? Alternatively, does the proposed definition include any items that should be excluded? If so, which ones and why?
22. Our proposal is designed, in part, to enhance comparability across registrants. Is comparability across registrants relevant or necessary in determining which compensation elements should be covered by the pay-versus-performance disclosure? Why or why not?
23. Under our proposed approach, the disclosure may not necessarily align a particular executive's compensation with the time period during which the registrant's performance may be attributed to the executive. For example, this may be the case where a turn-around specialist is hired and provided a substantial incentive payment up front in order to assume the task of improving the company's performance. Should our approach account for this? If so, should we

84 *See* proposed Instruction 1 to Item 402(v). Note that if the original award had been modified before it vested, the compensation actually paid would be determined only twice, as the pro rata fair value of the modified award at each of its two vesting dates.

require this to be addressed in supplemental disclosure? Are there other approaches we should consider?

24. Instead of our proposal, should we permit a principles-based approach that would allow registrants to determine which elements of compensation to include, so long as they clearly disclosed how the amount was calculated? Why or why not? How should such a provision be structured? What requirements should we include?
25. Are there alternative methods of determining which compensation is relevant to pay-versus-performance disclosure that we should consider?
26. Instead of our proposal, should we require only the use of the total compensation reported in the Summary Compensation Table and permit registrants to supplement this disclosure as they determine best reflects how their compensation relates to company performance? How would this approach affect the usefulness, comparability and cost of the pay-versus-performance disclosure?
27. Does our proposal to require only the actuarial present value of benefits attributable to services rendered during the applicable fiscal year, rather than the change in actuarial present value of pension benefits that is required by the Summary Compensation Table, appropriately reflect compensation "actually paid" to NEOs during that year for purposes of the pay-versus-performance disclosure mandated by Section 14(i)?
28. Is our proposal to include in the Item 402(v) calculation only above-market or preferential earnings on deferred compensation that is not tax-qualified appropriate? Should the calculation instead include all earnings on deferred compensation that are not tax-qualified rather than just the above-market portion?

Should the calculation only include the above-market portion once any vesting conditions applicable to those earnings have been satisfied?

29. Should we value equity awards at vesting date fair value as proposed? Should we instead value equity awards at grant date fair value as currently required by Item 402(c)(2)(v) and (vi) or fair value at some other point in time? If so, why? Should we require disclosure of vesting date valuation assumptions if they are materially different from those disclosed in a registrant's financial statements as of the grant date, as proposed? Would the disclosure of these assumptions provide meaningful information to shareholders?

30. What concerns, if any, are presented if we require equity awards to be valued at vesting date fair value as opposed to grant date fair value? Would any concerns be mitigated by the inclusion in the table of the total compensation amount as provided in the Summary Compensation Table?

31. Should any other components of compensation, such as registrant contributions to defined contribution plans, also be included only after any applicable vesting conditions have been satisfied?

32. For equity awards that require exercise, is our proposal to consider them "actually paid" when vested the appropriate point in time for purposes of Item 402(v) disclosure? If not, please explain. Should we instead require that for an award that requires exercise to be considered "actually paid," it must also be exercisable, making the valuation date the date on which the award is both vested and exercisable? Is there an alternative approach we should consider?

33. Are there other specific elements of compensation in the Summary Compensation Table that we should exclude or modify for purposes of the pay-versus-performance disclosure called for under proposed Item 402(v)?

E. Measure of Performance

We are proposing to require that registrants use TSR (as defined in Item 201(e) of Regulation S-K) as the measure of financial performance of the registrant for purposes of pay-versus-performance disclosure.[85] Exchange Act Section 14(i) does not specify how registrant financial performance is to be measured, although the language in the statute requires financial performance to take into account any change in the value of the shares of stock and dividends of the registrant and any distributions of the registrant. We believe using TSR as the measure of financial performance is consistent with this requirement and we received several comments that supported this approach.[86]

Several commenters in the pre-proposal stage indicated that absolute company performance may not be a sufficient basis for comparison and advocated disclosure of registrant performance relative to that of a peer group.[87] Consistent with these suggestions, we also are proposing to require registrants, other than smaller reporting companies, to disclose peer group total shareholder return, using either the same peer

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[85] Item 201(e) of Regulation S-K, which prescribes disclosure for the stock performance graph included in the annual report to security holders required by Rules 14a-3 and 14c-3, provides that cumulative total shareholder return is calculated by "dividing the (i) sum of (A) the cumulative amount of dividends for the measurement period, assuming dividend reinvestment, and (B) the difference between the registrant's share price at the end and the beginning of the measurement period; by (ii) the share price at the beginning of the measurement period." 17 CFR 229.201(e).

[86] *See* letters from ClearBridge, Compensia, Farient, Meridian and MDU.

[87] *See* letters from Farient, J&J, MDU, Pay Governance, Shareholder Value Advisors.

group used for purposes of Item 201(e) of Regulation S-K,[88] or, a peer group used in the CD&A for purposes of disclosing registrants' compensation benchmarking practices.[89] If the peer group is not a published industry or line-of-business index, the registrant would be required to disclose the identity of the issuers. A registrant that has previously disclosed the composition of issuers in its peer group in prior filings with the Commission would be permitted to comply with the proposed requirement by incorporation by reference to those filings. We believe this would avoid the potential for duplicative disclosure.

Requiring registrants to use a consistently calculated measure, such as TSR, should increase the comparability of pay-versus-performance disclosure across registrants. Using TSR also would provide a measure of financial performance that is objectively determinable from the share price of the registrant and not open to subjective determinations of performance. In addition, using a measure that registrants are already required to determine and disclose, and with which shareholders already are familiar, would reduce the burden of providing and analyzing pay-versus-performance disclosure as compared to requiring registrants to calculate and shareholders to review a new measure of financial performance.

Some commenters suggested permitting registrants to choose the performance measure best-suited for their company.[90] One commenter suggested that registrants

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88 17 CFR 229.201(e)(1)(ii).

89 *See* Item 402(b)(xiv) of Regulation S-K (17 CFR 229.402(b)(xiv)). We note that smaller reporting companies are not subject to Item 201(e) and that requiring disclosure of peer group total shareholder return would require smaller reporting companies to collect and disclose information that they are not currently required to disclose.

90 *See* letters from ABA, CEC I, Davis Polk, Protective Life and SCSGP.

should be required to present additional performance measures.[91] We note that, as with other mandated disclosures, registrants would be permitted to provide supplemental measures of financial performance so long as any additional disclosure is clearly identified, not misleading and not presented with greater prominence than the required disclosure.

Request for Comment

34. Should we require registrants to use TSR as the performance measure? Would the comparability across registrants resulting from this proposal benefit shareholders? Would prescribing the use of TSR hinder registrants from providing meaningful disclosure about the relationship between executive pay and financial performance? Would requiring the use of TSR result in shareholders or management focusing too much on this single measure of performance or emphasizing short-term stock price improvement over the creation of long-term shareholder value? If so, are there ways we could mitigate that risk?
35. Should we allow registrants flexibility in choosing the relevant measure of performance they are required to disclose? Besides TSR, what other measures of financial performance take into account any change in the value of the shares of stock and dividends and distributions of the registrant, as required by the statute? Are there metrics other than TSR that measure a company's performance and meet the requirements of the statute? If so, would they result in disclosures that

[91] *See* letter from Public Citizen (recommending that registrants be required to present the relationship of compensation with four performance measures: total shareholder return, return on assets, return on equity, and the growth in earnings per share).

are more or less meaningful than TSR? How is corporate performance measured today? How is this information incorporated into investment decisions?

36. If companies do not currently use TSR as a factor in determining executive compensation, could requiring disclosure of this relationship cause companies to change their compensation strategy to focus on this factor? If so, what would be the effect?

37. Does TSR, standing alone, provide sufficient information about a registrant's performance such that a registrant would provide only the information that would be mandated by this rule? Will registrants opt to provide additional information based on their own calculations or metrics to provide additional context for investors to consider the alignment of pay versus performance?

38. Should we permit voluntary use of other measures of performance in addition to TSR, as proposed? Should we instead include specific requirements relating to the use of alternative performance measures in the proposed rules?

39. Should we require disclosure of TSR on an absolute basis, as well as disclosure of peer group TSR, as proposed? Why or why not? Are there other parameters we should consider requiring registrants to implement for the selection of peer groups?

40. Should we require disclosure about the registrant's selection of the peer group? For example, if a registrant using a peer group changes its peer group from one

used in the previous fiscal year, should we require a brief narrative explaining the reasons for the change?[92]

41. Our proposal requires a registrant to use the same peer group used for purposes of Item 201(e) or the CD&A. Should a registrant be permitted to choose between these two options, or should we prescribe which peer group should be used? Why or why not? Should a registrant be permitted to choose a peer group different from that used for purposes of Item 201(e) or its CD&A? Please explain. Should there be any restrictions on how registrants select their peer groups?

F. Time Period Covered

Section 14(i) does not specify the time period that the pay-versus-performance disclosure must cover. Several commenters expressed concern that meaningful pay-versus-performance disclosure would need to address the time periods over which pay and performance are evaluated.[93] Commenters recommended a variety of solutions to provide meaningful disclosure, recommending varying types of disclosure over varying time periods.[94]

For registrants other than smaller reporting companies, we are proposing to require registrants to provide the pay-versus-performance disclosure for the five most

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92 *See, e.g.*, Item 201(e)(4) of Regulation S-K, which provides that if a registrant chooses a different index for the stock performance graph than the one used in the previous fiscal year, then the registrant is required to explain the reason for the change and is also required to compare total return with both the old and the new index.

93 *See, e.g.,* letters from ClearBridge, Pay Governance and SCSGP.

94 *See* letters from Brian Foley & Company, ClearBridge and Pay Governance (supporting a one-year and a three-year aggregate disclosure to capture annual and long-term compensation); J&J (including a copy of their proxy materials in which they disclosed their PEO's annual compensation over five years in relation to total shareholder return and provided a separate table showing aggregate compensation over a three-year period relative to a peer group); and from Baker Donelson, Cook, Meridian, and MDU (supporting a five-year time period).

recently completed fiscal years.[95] As noted above, several commenters supported a disclosure period of five years.[96] While the Summary Compensation Table required by Item 402(c) of Regulation S-K requires compensation disclosure for each of the last three completed fiscal years, we note that the stock performance graph required by Item 201(e) of Regulation S-K requires disclosure for the previous five fiscal years, although it does not include any compensation information. We believe that requiring disclosure of the relationship between executive compensation and registrant performance over the five most recently completed fiscal years is appropriate because it provides a meaningful period over which a relationship between annual measures of pay and performance over time can be evaluated.[97]

Smaller reporting companies would be required to provide the disclosure for the three most recently completed fiscal years.[98] Our executive compensation rules require smaller reporting companies to provide disclosure for only the last two completed fiscal years,[99] but we believe that requiring pay-versus-performance disclosure for three fiscal years, instead of two, provides more useful information from which investors can evaluate the relationship between a registrant's executive compensation actually paid and its financial performance, and provides a longer time horizon over which to observe any potential trends. We also are proposing to provide a transition period for registrants to

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95 *See* proposed Item 402(v)(2) of Regulation S-K.

96 *See* letters from Baker Donelson, Frederic Cook, MDU (noting that a five-year measurement period moderates annual volatility and leads to more balanced comparisons), and Meridian.

97 We are proposing to require smaller reporting companies to provide the disclosure over three years because they are not subject to Item 201(e) and provide Summary Compensation Table disclosure for two completed fiscal years. See Item 402(n) of Regulation S-K.

98 *See* proposed Instruction 8 to Item 402(v)(2) of Regulation S-K.

99 *See* Item 402(n) of Regulation S-K.

provide the disclosure. Existing smaller reporting companies would be required to provide the disclosure for only the last two fiscal years in the first applicable filing after the rules become effective. In subsequent years such companies would be required to provide disclosure for the last three fiscal years.[100] Any other registrants would be required to provide the proposed Item 402(v) disclosure for three fiscal years, instead of five, in the first applicable filing after the rules become effective, and provide disclosure for an additional year in each of the two subsequent annual proxy filings where disclosure is required.

We are also proposing that a registrant provide pay-versus-performance disclosure only for years that it was a reporting company pursuant to Section 13(a) or Section 15(d) of the Exchange Act. Thus, a newly-reporting registrant would be required to provide pay-versus-performance disclosure for only the most recently ended fiscal year in any proxy statement or information statement in which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required in its first year as a reporting company, and in the two most recently completed fiscal years in any proxy statement or information statement in which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required in its second year as a reporting company. This treatment is consistent with the phase-in period for new reporting companies in their Summary Compensation Table disclosure.[101]

Request for Comment

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[100] *See* proposed Instruction 1 to Item 402(v).

[101] *See* Instruction 1 to Item 402(c) of Regulation S-K. Similarly, Item 201(e)(2) provides that if the registrant has been registered under Section 12 for a shorter period of time than the prescribed measurement period, the period covered by the performance graph may correspond to that time period.

42. Does a five-year disclosure period (for registrants other than smaller reporting companies) and a three-year disclosure period (for smaller reporting companies), as proposed, provide meaningful pay-versus-performance disclosure? Should the timeframes be shorter or longer? For example, should we require only three years of disclosure for all registrants consistent with the time period required by the Summary Compensation Table for registrants other than smaller reporting companies? What impact would a different time period have on the disclosure and its usefulness to shareholders?

43. Should we provide the proposed transition period for existing registrants? Why or why not? Should the transition period be shorter or longer? Does it depend on the type of registrant?

44. Should we permit registrants voluntarily to include fiscal years beyond the five-year period, as proposed? Please explain why or why not. Is there a risk that some registrants may choose the time period which is most favorable for performance? How could we mitigate this risk?

45. Is the proposed phase-in for new reporting companies appropriate? Is sufficient information readily available for these companies to provide adequate pay-versus-performance disclosure in any proxy statements or information statements requiring Item 402 disclosure in their first two years as a reporting company? If not, what are the costs of developing this information? Would pay-versus-performance disclosure for only the most recently completed fiscal year in the first proxy statement filed by a newly-reporting company, as proposed, provide sufficient and meaningful information for shareholders to evaluate the executive

compensation actually paid as compared to the registrant's financial performance, given the limited time period covered? Does the importance of the information to shareholders justify the costs of preparing the disclosure without a phase-in period?

46. Should the pay-versus-performance disclosure be required to use annual data from the five most recently completed fiscal years, as proposed, or aggregated data for the five most recently completed fiscal years? If the years are aggregated, should the relationship between pay and performance be demonstrated across peers because it can no longer be demonstrated over time? Alternatively, should the pay-versus-performance comparison be presented for both the last completed fiscal year and in aggregate for the five most recently completed fiscal years? If so, please explain why a different period and different level of aggregation than proposed would be more informative to shareholders or otherwise more appropriate.

47. Are there other transition issues or accommodations that we should consider? For example, should emerging growth companies[102] that are statutorily excluded from the requirements of Section 14(i) be provided the same phase-in period of pay-versus-performance disclosure applicable to other registrants when they first become subject to the proposed requirement to provide five fiscal years of pay-versus-performance disclosure?

[102] Section 102(a)(2) of the JOBS Act excludes "emerging growth companies" from the requirements of Section 14(i). In accordance with this provision, we are not proposing to require an emerging growth company to provide pay-versus-performance disclosure.

G. Clear Description

Exchange Act Section 14(i) requires a "clear description" of the compensation disclosure required by Item 402 of Regulation S-K. We believe the requirement in Item 402(a)(2) of Regulation S-K[103] for "clear, concise and understandable disclosure" and the Plain English principles in Exchange Act Rules 13a-20[104] and 15d-20[105] give effect to the requirement in new Section 14(i) of the Exchange Act for clear compensation disclosure. When the current compensation disclosure requirements were adopted, we also amended Exchange Act Rules 13a-20 and 15d-20 so that the Plain English principles would apply to the amended compensation disclosure.[106] In adopting the Plain English requirement for compensation disclosure, we stated, "clearer, more concise presentation of executive and director compensation . . . can facilitate more informed investing and voting decisions in the face of complex information about these important areas."[107] We think this statement applies equally to pay-versus-performance disclosure. In addition, we noted that the Plain English principles applicable to compensation disclosure would permit registrants to "include tables or other design elements, so long as the design is not misleading and the required information is clear, understandable, consistent with applicable disclosure requirements, consistent with any other included information, and not misleading."[108] As a result, registrants are permitted to provide additional

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103 17 CFR 229.402(a)(2).

104 17 CFR 240.13a-20.

105 17 CFR 240.15d-20.

106 *See Executive Compensation Release, supra* note 76.

107 *Id.*

108 *Id.*

information beyond what is specifically required by our rules so long as the information is not misleading and does not obscure the required information.

Request for Comment

48. Are there changes to our rules that are necessary or appropriate in order to give effect to the requirement in Section 14(i) of the Exchange Act for a clear description of the Item 402(v) compensation disclosure?
49. Is it appropriate to apply the Plain English principles to the pay-versus-performance disclosure? If not, please explain why.

H. Smaller Reporting Companies

As proposed, smaller reporting companies as defined in Item 10(f)(1) of Regulation S-K[109] would be required to provide Item 402(v) disclosure. In an effort to minimize the reporting costs for these registrants, consistent with the Commission's treatment of smaller reporting companies in other areas (*e.g.*, executive compensation), these companies would be permitted to provide scaled disclosure, as follows:

- First, smaller reporting companies would be required to present Item 402(v) disclosure for the three most recently completed fiscal years, as opposed to the five most recently completed fiscal years required for other registrants. This is consistent with our general approach to scaling the requirements for executive compensation disclosure provided by smaller reporting companies.
- Second, smaller reporting companies would not be required to disclose amounts related to pensions for purposes of disclosing executive

109 17 CFR 229.10(f)(1).

compensation actually paid because they are subject to scaled compensation disclosure that does not include pension plans.

- Finally, smaller reporting companies would not be required to present a peer group TSR. Smaller reporting companies are not subject to Item 201(e) and therefore are not otherwise required to present the TSR of a peer group, and they are not required to present a CD&A.

In addition, as proposed, the rule includes a transition period that would permit an existing smaller reporting company to provide two years of data, instead of three, in the first applicable filing after the rules become effective, and three years of data in subsequent proxy filings.

Smaller reporting companies are only required to provide Summary Compensation Table disclosure for the two most recently completed fiscal years. While the time period applicable for the proposed disclosure is longer than what smaller reporting companies currently are required to disclose in the Summary Compensation Table, we note that the information required to make the pay-versus-performance calculations for these additional years would be available in disclosures from prior years.

As proposed, smaller reporting companies would be required to provide the disclosure in the prescribed table in XBRL format, but we are proposing a phase-in under which smaller reporting companies would be required to provide the data in XBRL beginning with the third filing in which it provides pay-versus-performance disclosure.[110]

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110 Providing a phase-in for smaller reporting companies is consistent with how we have previously implemented certain new disclosure requirements applicable to these companies. *See, e.g.*, *Interactive Data to Improve Financial Reporting*, Release No. 33-9002 (Jan. 30, 2009) [74 FR 6776 (Feb. 10, 2009)]; *Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, Release No. 33-9178 (Jan. 25, 2011) [76 FR 6010 (Feb. 2, 2011)].

This phase-in is intended to permit smaller reporting companies to plan and implement their data tagging with the benefit of the experience of other registrants that do not have a phase-in. It also will give them a longer period of time over which to spread first-year data tagging costs. While we recognize that requiring this disclosure to be provided in interactive data format would impose additional costs and burdens on these companies, beyond what they currently incur in producing interactive data for other purposes in other filings, we anticipate that these expenses would be relatively lower than what they currently incur in producing interactive data for other purposes given the limited disclosures that would be required to be tagged.

We do not expect the compliance burden associated with providing this disclosure to be substantial given that much of the information required by the proposed rule is derived from information currently required under existing Regulation S-K. We also note that smaller reporting companies are subject to the say-on-pay advisory votes required under Exchange Act Rule 14a-21,[111] which the pay-versus-performance disclosure required under proposed Item 402(v) is intended to facilitate. We believe that shareholders of smaller reporting companies may benefit from having the proposed pay-versus-performance disclosure when casting their say-on-pay advisory votes and that such disclosure can be provided without imposing undue costs on smaller registrants.

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[111] *See* Release No. 33-9178, *supra* note 10 ("We do not believe that smaller reporting companies should be permanently exempt from the say-on-pay vote, frequency of say-on-pay votes and golden parachute and vote because we believe investors have the same interest in voting on the compensation of smaller reporting companies and in clear and simple disclosure of golden parachute compensation in connection with mergers and similar transactions as they have for other issuers.").

50. Would the proposed scaled disclosure requirements for smaller reporting companies provide meaningful disclosure to investors without imposing undue costs and burdens on these companies? Are there ways we could modify the proposed disclosure requirements to reduce the costs and still provide useful information for shareholders? For example, should we require only a two-year disclosure period for smaller reporting companies (similar to the timeframe for which they are required to provide disclosure in the Summary Compensation Table)?

51. Should we exempt smaller reporting companies from the proposed pay-versus-performance disclosure requirements? Why or why not? What impact, if any, would the absence of the proposed disclosure have on the ability of shareholders of smaller reporting companies to effectively exercise of their say-on-pay voting rights? Would shareholders be able to assess the relationship between the company's financial performance and the compensation paid absent the disclosure required under proposed Item 402(v)? Would the proposed disclosure be more or less meaningful to shareholders in the absence of CD&A and Item 201(e) performance graph disclosure? What are the burdens on smaller reporting companies of requiring pay-versus-performance disclosure and would the benefits of requiring this disclosure for smaller reporting companies justify the burdens? If not, please explain why not. Should registrants that exit smaller reporting company status be provided the same phase-in period applicable to other registrants when they first become subject to the proposed requirement to provide five fiscal years of pay-versus-performance disclosure?

III. General Request for Comments

We request and encourage any interested person to submit comments on any aspect of our proposals, other matters that might have an impact on the amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

In addition, we request data to quantify the costs and the value of the benefits described in this release. We seek estimates of these costs and benefits, as well as any costs and benefits not already defined, that may result from the adoption of these proposed amendments. We also request qualitative feedback on the nature of the benefits and costs we have identified and any benefits and costs we may have overlooked.

To assist in our consideration of these costs and benefits, we specifically request comment on the following:

52. Would there be any significant transition costs imposed on registrants as a result of the proposal, if adopted? Please be detailed and provide quantitative data or support, as practicable.
53. Have we struck the appropriate balance between prescribing rules to satisfy the requirements of Exchange Act Section 14(i) and allowing registrants to disclose pay-versus-performance information most relevant to shareholders?
54. Are there alternatives to the proposals we should consider that would satisfy the requirements of Section 14(i) of the Exchange Act?

IV. Economic Analysis

A. Background

As discussed above, Section 953(a) of the Dodd-Frank Act added Section 14(i) to the Exchange Act, directing the Commission to require registrants to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders the relationship between executive compensation actually paid and the financial performance of the registrant. Section 14(i) of the Exchange Act does not define key terms, such as "executive compensation actually paid" or issuer "financial performance," or prescribe a specific format for this disclosure. As a result, we apply discretion in our proposed implementation of the provision.

New Item 402(v) proposed by the Commission to satisfy the mandate of Section 14(i) requires the disclosure of information that is largely already required to be reported under current disclosure rules, but that is currently not computed or presented in the way the proposal would require. The proposal requires registrants to present the values of prescribed measures of executive compensation and performance for each of their five most recently completed fiscal years (three years for smaller reporting companies) in a standardized table. Registrants would be required to provide a clear description of the relationship between these measures, but would be allowed to choose the format used to present the relationship, such as a graph or narrative description. The proposal would also allow registrants to supplement the required elements of the disclosure with additional measures or additional years of data. The disclosure would be required to be provided in tagged data format using XBRL.

The proposed amendments would require that the compensation covered by the disclosure be "executive compensation actually paid." Registrants would also be required to include the Summary Compensation Table measure of total compensation in the tabular disclosure for purposes of comparison. The proposal defines executive compensation actually paid as total compensation, as currently disclosed in the Summary Compensation Table, with modifications to the amounts disclosed for pension benefits (under all defined benefit and actuarial pension plans) and equity awards in order to better reflect amounts "actually paid."

Specifically, we propose that, instead of the total change in actuarial pension value, executive compensation actually paid include only the actuarial present value of benefits attributable to services rendered during the applicable fiscal year. That is, the measure would exclude that part of the change in actuarial pension value that results from any change in the actuarial value of benefits accrued in previous years, and should thus increase the comparability between compensation provided through defined benefit and defined contribution plans. This adjustment is also expected to reduce the volatility in measured pension compensation caused by changes in interest rates and other actuarial assumptions, and should thus make it easier to evaluate the relationship of pay-versus-performance. Because the scaled compensation disclosure that applies to smaller reporting companies does not include pension plans, this adjustment would not be required of smaller reporting companies. We also propose that executive compensation actually paid include the values of equity awards at the time of vesting rather than the date they are granted. Using vesting-date valuations would result in a compensation measure that includes, upon the vesting date, the grant date value of equity awards plus or minus any change in the value of equity awards between the grant and vesting date. As discussed below, such changes in the value of equity awards after the grant date represent a direct channel, and one of the primary means, though which pay is linked to registrant performance. We therefore believe that it is important that such changes in the value of equity awards be reflected in the pay-versus-performance disclosure.[112]

All of the individual components needed to calculate executive compensation actually paid must already be reported under current disclosure rules, with the exception of the values to be included with respect to pension benefits and option awards. The actuarial present value of pension benefits of an individual NEO attributable to services rendered during the applicable fiscal year is not currently required to be reported but can be estimated by shareholders based on existing disclosures with respect to pension benefits and pension valuation assumptions. The vesting-date values of option awards can similarly be estimated by shareholders using existing disclosures regarding the terms of option awards, their grant-date values and grant-date valuation assumptions, but arriving at such estimates could require shareholders to make vesting-date valuation assumptions that could differ from the grant-date valuation assumptions. The disclosure of executive compensation actually paid may therefore provide shareholders with marginal new information about the particular assumptions made by registrants in estimating vesting-date valuations.

[112] To the extent that some shareholders may be interested in considering the relationship of performance with a measure of pay that excludes such changes in the value of equity awards, they would be able to refer to the Summary Compensation Table measure of total compensation required alongside executive compensation actually paid in the tabular disclosure. The Summary Compensation Table measure of total compensation reflects the grant date values of equity awards.

The proposed amendments would require TSR to be the measure of financial performance used for the pay-versus-performance disclosure. Registrants other than smaller reporting companies would be required to include the TSR for a peer group as well as the registrants' own TSR in the required table. Registrants would also be required to provide a description of the relationship of their own TSR with executive compensation actually paid and, for registrants other than smaller reporting companies, of their own TSR with the reported peer group TSR. For this purpose, registrants may use the peer group used for their Item 201(e) performance graph in their annual report or the peer group used in their CD&A, if any.

The proposed amendments would permit registrants to present supplemental measures of both performance and compensation. Also, the proposed amendments would not prescribe the format in which the relationship between executive compensation actually paid and TSR is presented, though the amendment would require that the disclosure present this relationship over the five prior fiscal years (three years for smaller reporting companies). The proposal would also require footnote disclosure of the adjustments made to compute executive compensation actually paid and disclosure of the vesting date valuation assumptions, if materially different from the grant date assumptions.

We are proposing these amendments to satisfy the statutory mandate of Section 14(i) of the Exchange Act. The Senate Report that accompanied the statute references shareholder interest in the relationship between executive pay and performance as well as the general benefits of transparency of executive pay practices.[113] As discussed above, we believe that the statute is intended to provide further disclosures for shareholders to consider when making say-on-pay voting decisions, as well as when making other voting decisions on the compensation plans in which NEOs participate, and making decisions pertaining to the election of directors.

Exchange Act Section 3(f) requires us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of shareholders, whether the action will promote efficiency, competition and capital formation. Exchange Act Section 23(a)(2) requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition and not to adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The discussion below addresses the economic effects of the proposed amendments, including its anticipated costs and benefits, as well as the likely effects of the proposed amendment on efficiency, competition, and capital formation. The proposed amendments reflect the statutory mandate in Section 14(i) as well as the discretion we exercise in implementing that mandate. For purposes of this economic analysis, we address the costs and benefits resulting from the statutory mandate and from our exercise of discretion together, recognizing that it is difficult to separate the costs and

113 The Senate Report includes the following with respect to Section 953(a) of the Dodd-Frank Act: "It has become apparent that a significant concern of shareholders is the relationship between executive pay and the company's financial performance of the issuers… The Committee believes that these disclosures will add to corporate responsibility as firms will have to more clearly disclose and explain executive pay." *See* the Senate Report *supra* note 7.

benefits arising from these two sources. We also analyze the potential costs and benefits of significant alternatives to what is proposed. We request comment throughout this release on alternative means of meeting the statutory mandate of Section 14(i) of the Exchange Act and on all aspects of the costs and benefits of the proposed approach and of possible alternatives. We also request comment on any effect the proposed disclosure requirements may have on efficiency, competition and capital formation.

B. Baseline

To assess the economic impact of the proposed amendments, we are using as our baseline the current state of the market without a requirement for registrants to disclose the relationship between executive compensation actually paid and the financial performance of the registrant. We consider the impact of the proposed amendment on shareholders, registrants, and their NEOs. The proposed amendments would apply to all companies that are registered under Section 12 of the Exchange Act and are therefore subject to the federal proxy rules, except emerging growth companies. The proposed amendments would also not apply to foreign private issuers or companies with reporting obligations only under Section 15(d) of the Exchange Act, which are not subject to the proxy rules. In addition, for some Section 12(g) registrants, such as limited partnerships, the disclosure requirement might not apply in some or all years because these registrants might not file either proxy or information statements every year.[114]

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114 Registrants subject to the proposed amendments would be required to make pay-versus-performance disclosure under proposed Item 402(v) when they file proxy statements or information statements in which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required. Proxy statement disclosure obligations only arise under Section 14(a) when a registrant with a class of securities registered under Section 12 chooses to solicit proxies. Whether or not a registrant has to solicit proxies is dependent upon any requirement under its charter and/or bylaws, or otherwise imposed by law in the state of incorporation and/or stock-

We estimate that approximately 6,075 registrants would be subject to the proposed amendments, including approximately 2,430 smaller reporting companies.[115] Among all registrants subject to the federal proxy rules, we estimate that there are approximately 360 emerging growth companies, of which approximately 230 are also smaller reporting companies, all of which would not be subject to the proposed amendments.[116]

The economic effects of pay-versus-performance disclosure will depend, in part, on whether new information that could not be derived from existing disclosures would be made available to shareholders. The proposed amendments are not expected to result in the provision of significant new information to shareholders, or to require registrants to collect significant new data, relative to disclosure requirements under the baseline. The registrants that would be subject to the proposed amendments must currently comply with Item 402 of Regulation S-K and, except in the case of smaller reporting companies, with Item 201(e). The underlying information required to provide the proposed pay-versus-performance disclosure is, with the exception of vesting-date valuation assumptions for

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exchange (if listed), not the federal securities laws. For example, NYSE, NYSE Market, and NASDAQ require the solicitation of proxies for annual meetings of shareholders. A Section 12(b) registrant is listed on a national securities exchange, and therefore likely would solicit proxies and be compelled to provide the disclosure identified in proposed Item 402(v) annually. Registrants with reporting obligations under Section 12(g), but not Section 12(b), would not be subject to any obligation to solicit proxies under the listing standards of an exchange, but may nevertheless solicit proxies as a result of an obligation under their charters, bylaws, or law of the jurisdiction in which they are incorporated. When Section 12 registrants that do not solicit proxies from any or all security holders are nevertheless authorized by security holders to take a corporate action at or in connection with an annual meeting or by written consent in lieu of such meeting, disclosure obligations also would arise under proposed Item 402(v) due to the requirement to file and disseminate an information statement under Section 14(c).

115 These estimates are based on a review of calendar year 2013 EDGAR filings.

116 *Id.*

options, already encompassed by these existing disclosure requirements and, for smaller reporting companies and for registrants that use a peer group from their CD&A, in the public availability of stock return data.

Specifically, Item 201(e) requires the disclosure of the TSR for the registrant as well as a peer group (a published industry or line-of-business index, peer issuers selected by the registrant, or issuers with similar market capitalizations), for the past five years, in annual reports.[117] The proposed amendments mandate that TSR of the registrant and a peer group be the primary measures of performance used in the pay-versus-performance disclosure. While registrants may instead choose to use the peer group disclosed in their CD&A, if they use a peer group in benchmarking their compensation, the components of such a peer group would be disclosed in the CD&A and the shareholder returns of these companies would be publicly available from many sources, if not already reported in the CD&A. Similarly, while smaller reporting companies are not required to comply with Item 201(e) or CD&A disclosure requirements and yet would still have to report their own TSR under the proposed rules, data about their returns is publicly available. The proposal does not require smaller reporting companies to present the performance of a peer group.

Further, Item 402 currently requires the affected registrants to disclose extensive information about the compensation of NEOs. For example, registrants subject to Item

[117] Item 201(e) disclosure is only required in an annual report that precedes or accompanies a registrant's proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). As discussed above, an annual meeting could theoretically not include an election of directors, such that Item 201(e) disclosure would not be required, although pay-versus-performance disclosure would still be required in such years if action is to be taken with regard to executive compensation.

402 are required to report the value of total compensation and each of its components,[118] including, for the affected registrants other than smaller reporting companies, the total change (if positive) in actuarial present value of pension benefits and, for all of the affected registrants, the grant-date value of equity awards, for all NEOs in the Summary Compensation Table. Item 402 requires further disclosure in additional related tables, footnotes, and/or the accompanying textual narrative. Based on this information, it would be possible in the absence of the proposed disclosure for shareholders to estimate the proposed measure of executive compensation actually paid by deducting the current values reported with respect to pension and equity awards from total compensation and then estimating and adding to this value the proposed revised values with respect to these two components where applicable.

Specifically, the proposed definition of executive compensation actually paid for a fiscal year is total compensation as reported in the Summary Compensation Table for that year (i) less the change in the actuarial present value of pension benefits,[119] (ii) less the grant-date value of any stock and option awards granted during that year that are subject to vesting, (iii) plus the actuarial present value of benefits attributable to services rendered during the applicable year, and (iv) plus the value at vesting of stock and option awards that vested during that year. Adjustments (i) and (iii) with respect to pension

118 For registrants that are not smaller reporting companies, total compensation consists of the dollar value of the executive's base salary and bonus, plus the fair market value at the grant date of any new stock and option awards, the value of any non-equity incentive plan awards, the change (if positive) in actuarial value of the accumulated benefit under all defined benefit and pension plans, any above-market interest or preferential earnings on deferred compensation and all other compensation. The all other compensation component includes, among other things, the value of perquisites and other personal benefits (unless less than $10,000 in aggregate) and registrant contributions to defined contribution plans.

119 If the change in actuarial value of pension plans is not positive, it is not currently included in total compensation and therefore need not be deducted for the purpose of this adjustment.

plans would not apply to smaller reporting companies as they are not otherwise required to disclose executive compensation related to pension plans. As discussed above, the amounts to be subtracted in this computation, as well as the value of stock awards at vesting (which must be added back), must be reported under existing Item 402 requirements. The other amounts that must be added back in this computation are not required to be directly reported under existing disclosure requirements but can be estimated based on existing disclosures. While the time period applicable for Item 402 disclosures (two years for smaller reporting companies and three years for other affected registrants) is shorter than would be required for the pay-versus-performance disclosure (three years for smaller reporting companies and five years for other affected registrants), the information required to make these computations for the additional years would be available in disclosures from previous years.

Thus, under the baseline, shareholders already have the required data to compute a reasonable estimate of the proposed measure of executive compensation actually paid, even though registrants are not required to compute or disclose this measure. In particular, as discussed above, the actuarial present value of benefits attributable to services rendered during the applicable fiscal year can be computed using the detailed existing disclosures of pension plan terms and valuation assumptions. It is also possible for shareholders to make reasonable estimates of the vesting-date fair values of options based on existing compensation disclosures and public data. However, as discussed above, estimates of vesting-date valuations computed by shareholders could differ from estimates computed by the registrant. Under the baseline, because registrants are not currently required to disclose vesting-date valuation assumptions (which may differ from grant-date assumptions), shareholders may not know how the registrant would apply its discretion in choosing from a range of reasonable assumptions to compute vesting-date valuations.

For the affected registrants other than smaller reporting companies, Item 402 also requires a description in the CD&A of how the registrant's compensation policy relates pay to performance, if material to the registrant's compensation policies and decisions. However, registrants are not currently required to report the actual historical relationship between any measures of compensation and financial performance. Some registrants voluntarily provide such disclosures, which are generally limited to analyses of the compensation of the PEO and which vary with regard to the compensation and performance measures used.[120] The comparability of these voluntary disclosures is therefore limited, and observers have raised concerns that registrants have selected measures that make the alignment of pay and performance appear more favorable.[121]

Certain shareholders also may have access to analyses of historical pay-versus-performance data produced by third parties, such as proxy advisory firms and compensation consultants. These analyses are based on compensation and performance

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120 A compensation consulting firm found that, of 250 large public companies examined, 27% provided tabular or graphical information on the relationship between pay and performance in the CD&A of their 2013 proxy statements, and the majority of these provided such information only with respect to the PEO's compensation. *See 2013 Corporate Governance & Incentive Design Survey*, Meridian Compensation Partners, Fall 2013, *available at* http://www.meridiancp.com/images/uploads/Meridian_2013_Governance_and_Design_Survey.pdf. In a study of the 300 largest companies filing proxy statements in the year ended April 2013, another consulting firm found over half a dozen different approaches to realizable pay-versus-performance disclosures. *See Executive Compensation 2013*, Hay Group, Feb. 2014, *available at* http://www.haygroup.com/downloads/us/exec_comp_2013.pdf.

121 *See, e.g.,* Dave Michaels, *Misleading CEO Pay-for-Performance Numbers Target of SEC*, Bloomberg, Dec. 17, 2013, *available at* http://www.bloomberg.com/news/2013-12-17/misleading-ceo-pay-for-performance-numbers-target-of-sec.html.

information disclosed by registrants, and they may apply more consistent methodologies across registrants, but the computations and analytical approaches used vary across the third-party information providers.[122] Some other shareholders may generate their own pay-versus-performance analyses, but we do not have access to information about the computations or approaches that they find to be useful.

An important factor to consider when analyzing the effects of the proposed pay-versus-performance disclosure requirements is the variation in compensation structures that is likely to exist among the affected registrants. In particular, because the proposed amendments require that equity awards and compensation related to pension plans be valued differently, and (in the case of equity awards) in different years than as valued in the Summary Compensation Table, the variation in usage and design of these items in executive compensation packages may affect the comparability of the disclosures and the burden involved in making the required calculations to provide the disclosures.

The proposed amendments require that executive compensation actually paid include the vesting-date values of stock grants, which are provided in the Option Exercises and Stock Vested Table but likely differ from the grant date values included in total compensation in the Summary Compensation Table. The use of stock grants, and the frequency of such grants to the CEO, by some of the potentially affected registrants is reported in the table below.[123]

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[122] *See, e.g.,* http://www.issgovernance.com/file/publications/evaluatingpayforperformance.pdf, and http://www.glasslewis.com/issuer/pay-for-performance for detail on quantitative analyses of pay for performance used by Institutional Shareholder Services Inc. and Glass Lewis & Co., LLC, respectively.

[123] These statistics are based on staff analyses of compensation data from the Standard & Poor's Execucomp database, which in turn is sourced from company proxy statements. Execucomp covers firms in the S&P Composite 1500 Index (which includes the S&P 500, S&P MidCap 400,

Table 1. Use of executive stock grants by registrants covered by Execucomp

	All Firms in Database	Firms in S&P 500	Firms in S&P MidCap 400	Firms in S&P SmallCap 600
Firms in Sample	1,812	496	396	598
Stock Grants to 2012 CEO:				
% of CEOs Granted Stock in 2012	80.2%	88.9%	87.4%	76.8%
Among firms for which 2012 CEO was also CEO in 2011 and 2010:				
% of CEOs Granted Stock 1 out of Past 3 Years (2010-2012) [124]	7.8%	3.6%	6.0%	10.6%
% of CEOs Granted Stock 2 out of Past 3 Years (2010-2012) [125]	10.3%	7.0%	7.9%	11.6%
% of CEOs Granted Stock 3 out of Past 3 Years (2010-2012) [126]	70.1%	81.1%	79.6%	62.2%
Stock Grants to Other 2012 NEOs:				
% of Firms that Granted Stock to Any NEO other than CEO in 2012	86.9%	94.4%	93.9%	83.4%
Among Firms that Made Such Grants, Average Number of Other NEOs Granted Stock in 2012	4.1	4.3	4.2	3.9

and S&P SmallCap 600) as well as some firms that were previously removed from the index but are still trading and some client requests. Years mentioned refer to fiscal years, under the convention that companies with fiscal closings after May 31 in a given year are assigned to that fiscal year while companies with fiscal closings on or before May 31 in a given year are assigned to the previous fiscal year. Use of the term "CEO" is based on the use of this term in the Execucomp database, and is believed to be equivalent to the term "principal executive officer" used in this release.

124 This percentage is only taken among those firms for which the CEO for the 2012 fiscal year was also the CEO in 2011 and 2010, and represents the percentage of such firms that issued this individual stock in only one fiscal year from 2010 through 2012.

125 This percentage is only taken among those firms for which the CEO for the 2012 fiscal year was also the CEO in 2011 and 2010, and represents the percentage of such firms that issued this individual stock in two fiscal years from 2010 through 2012.

126 This percentage is only taken among those firms for which the CEO for the 2012 fiscal year was also the CEO in 2011 and 2010, and represents the percentage of such firms that issued this individual stock every fiscal year from 2010 through 2012.

The proposed amendments require that executive compensation actually paid include the vesting-date values of option grants, values that are not currently reported and likely differ from the grant date values included in total compensation in the Summary Compensation Table. The use of option grants, and the frequency of such grants to the CEO, by some of the potentially affected registrants is reported in the table below. [127]

Table 2. Use of executive stock option grants by registrants covered by Execucomp

	All Firms in Database	Firms in S&P 500	Firms in S&P MidCap 400	Firms in S&P SmallCap 600
Firms in Sample	1,812	496	396	598
Option Grants to 2012 CEO				
% of CEOs Granted Options in 2012	50.3%	64.1%	49.0%	43.1%
Among firms for which 2012 CEO was also CEO in 2011 and 2010:				
% of CEOs Granted Options 1 out of Past 3 Years (2010-2012) [128]	10.6%	6.5%	11.0%	12.2%
% of CEOs Granted Options 2 out of Past 3 Years (2010-2012) [129]	12.3%	9.8%	11.6%	12.2%
% of CEOs Granted Options 3 out of Past 3 Years (2010-2012) [130]	42.4%	59.8%	40.9%	34.3%
Option Grants to Other 2012 NEOs:				

127 *See supra* note 123.

128 This percentage is only taken among those firms for which the CEO for the 2012 fiscal year was also the CEO in 2011 and 2010, and represents the percentage of such firms that issued these individual options in only one fiscal year from 2010 through 2012.

129 This percentage is only taken among those firms for which the CEO for the 2012 fiscal year was also the CEO in 2011 and 2010, and represents the percentage of such firms that issued these individual options in two fiscal years from 2010 through 2012.

130 This percentage is only taken among those firms for which the CEO for the 2012 fiscal year was also the CEO in 2011 and 2010, and represents the percentage of such firms that issued these individual options every fiscal year from 2010 through 2012.

% of Firms that Granted Options to Any NEO other than CEO in 2012	57.8%	68.5%	55.8%	51.3%
Among Firms that Made Such Grants, Average Number of Other NEOs Granted Options in 2012	3.9	4.2	4.0	3.6

In addition, because the proposed amendments require the valuation of equity awards as of their vesting dates, it is also important to consider the variation in time-based vesting schedules. In particular, the proposed measure of executive compensation actually paid includes the vesting-date value of equity awards that vested during the applicable year. The measure as of vesting reflects the grant-date valuation as well as changes in value of the award between the grant and vesting date, such as those related to gains and losses of the underlying stock since the award was granted. The proposed measure of executive compensation actually paid may thus increase sharply in any year during which significant equity awards vest. The degree of volatility in the executive compensation actually paid measure that may result is likely to be higher when grants vest all at once or when vesting dates are less frequent.

A compensation research and services firm estimates that 34% of stock grants and 6.8% of option grants awarded by S&P 1500 firms in 2012 are scheduled to vest in full at the end of their vesting period ("cliff vesting") while the remaining are scheduled to vest in increments over the period of vesting ("graded vesting").[131] Considering grants awarded over a longer horizon, an academic study that explored the vesting of option

[131] *See* Equity Vesting Schedules for S&P 1500 CEOs, a 2013 report by Equilar, *available at* http://www.equilar.com/corporate-governance/2013-reports/equity-vesting-schedules-for-s-p-1500-ceos.

grants of some of the potentially affected registrants from 1997 to 2008 found that 32% of the grants studied cliff vested, 55% vested in equal installments over the period of vesting, and 13% had an alternative, irregular vesting pattern.[132] Some equity awards may also be subject to performance-based vesting conditions, where the performance conditions may be based on the registrants' stock prices, their accounting performance, one or more nonfinancial measures, or some combination of these. A preliminary academic study finds that performance-based vesting conditions have become more prevalent in recent years, such that in 2012 just under 70% of large U.S. firms utilized such a provision in a grant to one or more executives, compared to approximately 20% of such firms in the year 2000.[133]

Another component of compensation that is measured differently in the proposed definition of executive compensation actually paid as compared to total compensation in the Summary Compensation Table is, for the affected registrants other than smaller reporting companies, compensation related to pension plans. The use of pension plans and the years of credited service at some of the potentially affected registrants are reported in the table below.[134]

Table 3. Use of pension plans by registrants covered by Execucomp

	All Firms in	Firms in	Firms in S&P	Firms in S&P

132 *See* B. Cadman, T. Rusticus, and J. Sunder, *Stock option grant vesting terms: Economic and financial reporting determinants*, REVIEW OF ACCOUNTING STUDIES, Vol. 18, No. 4, (Dec. 2013), at 1159-1190. Because this paper uses data from 1997 to 2008, it might not accurately reflect current practices.

133 *See* J. C. Bettis, J. Bizjak, J. Coles, and S. Kalpathy, *Performance-Vesting Provisions in Executive Compensation*, working paper (Dec. 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2289566.

134 *See supra* note 122.

	Database	S&P 500	MidCap 400	SmallCap 600
Firms in Sample	1,812	496	396	598
2012 Pension Plans				
% of CEOs with Pension Plans	33.7%	54.0%	37.6%	21.9%
Among Firms with CEO Plans, Median Years of Credited Service in Pension Plan	20	23	19	19
% Firms with Pension Plans for any NEO other than CEO	38.9%	59.9%	41.2%	26.4%
Among Firms with Other NEO Plans, Average Number of Other NEOs with Pension Plans	3.3	3.6	3.2	3.0

For the affected registrants other than smaller reporting companies, the proposed amendments require that executive compensation actually paid include only the actuarial present value of benefits attributable to services rendered during the applicable fiscal year, a value which is not currently required to be reported and will usually differ from the total change in actuarial value of pension benefits included, if positive, in total compensation reported in the Summary Compensation Table. In particular, the value currently included in total compensation reflects the change in actuarial pension value related to changes in the value of benefits accrued in prior years as well as the value of benefits attributable to services rendered during the applicable fiscal year. As such, the value currently included with respect to pensions in total compensation reported in the Summary Compensation Table will generally be more volatile (because of changes in interest rates and other actuarial assumptions) than the value to be included with respect to pensions in the proposed executive compensation actually paid measure. The degree of difference between these two computations will generally increase with an executive's total number of years of credited service (and thus the extent of benefits already accumulated) under the pension plan.

C. Discussion of Economic Effects

Compensating executive officers with pay that varies with registrant performance is widely considered to be a tool that can be used to encourage executive officers, through the financial incentives provided by such compensation plans, to exert effort and make decisions that create value. However, there are also downsides of such compensation plans. For example, some such plans may cause executives to focus overly on short-term performance to the detriment of long-term performance, or may make some executives less likely to take on risky but (from a typical shareholder's perspective) valuable investments if they are unwilling to take the chance that the investment could fail and result in lower compensation than would result from less risky projects.

An optimal compensation policy is generally considered to be one that maximizes shareholder value in the long term by balancing the need to provide executives with the incentive to perform well against the monetary costs and potential detrimental effects of the compensation policy. What constitutes an optimal compensation policy, including which performance metrics should be considered and how much compensation should vary with these metrics, is difficult to ascertain and will vary with a registrant's individual circumstances. Academic research has been mixed as to whether prevailing compensation structures are optimal, are too closely linked to company performance, or should be more sensitive to performance.[135] Thus, it is unclear whether changes that would more closely link executive pay with registrant performance than current

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[135] *See, e.g.,* Alex Edmans and Xavier Gabaix, *Is CEO Pay Really Inefficient? A Survey of New Optimal Contracting Theories*. EUR. FIN. MGMT, Vol. 15, No. 3, (June 2009), at 486-496, Michael Jensen and Kevin Murphy, *Performance Pay and Top-Management Incentives*. 98 J. POL. ECON., No. 2, 225 (Apr. 1990), and Lucian Bebchuk and Jesse Fried, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION, Harvard University Press, Oct. 2006.

compensation structures would have a positive, negative, or no impact on firm value creation.

In addition to uncertainties about the optimality of pay-versus-performance alignment, there are challenges in measuring such alignment. For example, the available performance statistics may not adequately measure a given executive's contribution to a registrant's performance, such as when registrant performance is strongly related to market moves, sector opportunities, commodity prices, or other factors unrelated to managerial effort or skill.[136] Even if the performance measure were not subject to such concerns, it could be difficult to match performance with associated compensation because of timing differences. For example, an executive may be rewarded with extra compensation for an accomplishment in the year it is made, even though expected profits related to this performance (such as an investment or restructuring decision) might not follow until several years later. Similarly, a registrant's stock price may rise at the announcement of a new PEO who is expected to add significant value to the firm, even though he or she may not commence employment and begin receiving compensation until the following year. Pay-versus-performance alignment can also be difficult to evaluate without also considering holdings of vested equity which link an executive's wealth to the performance of the company even if they were not obtained as compensation or, if

136 *See, e.g.,* Marianne Bertrand and Sendhil Mullainathan, *Are CEOS Rewarded for Luck? The Ones without Principals Are*, 116 Q. J. OF ECON., No. 3, 901(2001). Other situations in which registrant performance statistics may differ from an executive's performance include cases in which the statistics measure managerial effort but not of the particular manager in question (which may be particularly likely in the case of NEOs other than the PEO) and situations in which other factors such as registrant size affect the translation of a given level of managerial effort into the measured statistics.

they were provided as compensation, even after they have been "actually paid."[137] Such issues may lead to concerns with any standardized approach to evaluating pay-versus-performance alignment.

Despite these challenges, shareholders may evaluate executive compensation packages and consider the optimality of pay-versus-performance alignment when making voting decisions relating to the compensation of the NEOs and the election of directors, as well as when making investment decisions.[138] As discussed above, shareholders currently have access to detailed information disclosed by registrants with respect to executive compensation and financial performance. For example, substantial detail on compensation packages is currently required in proxy statements where action is to be taken with regard to the election of directors, including the specific terms of performance-related awards as well as information in the CD&A (for affected registrants other than smaller reporting companies) regarding how the compensation policy relates pay to performance, to the extent it is considered material. However, data from the required, standardized tables and accompanying information may require further computation and analysis before shareholders can evaluate actual historical pay-versus-performance alignment. Also, CD&A disclosures that may, on a voluntary basis, provide

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137 *See, e.g.,* Kevin J. Murphy, *Executive Compensation: Where We Are, and How We Got There*, August 12, 2012, forthcoming in George Constantinides, Milton Harris, and René Stulz (eds.), HANDBOOK ECON. FIN., at 24-25, *available at* SSRN: http://ssrn.com/abstract=2041679 (stating that incentive compensation is negatively correlated with manager's vested equity interests, reflecting the redundancy of granting further equity awards to executives whose wealth is already substantially tied to the company's equity).

138 *See, e.g., 2015 Investor Survey: Deconstructing Proxy Statements – What Matters to Investors*, February 2015, Stanford University, RR Donnelley, and Equilar, February 2015, *available at* http://www.sec.gov/comments/4-681/4681-3.pdf (providing survey evidence that 64% of institutional investors surveyed indicated that their firms used pay-for-performance alignment information from proxy statements to make voting decisions; 34% of those surveyed indicated that this information was used to make investment decisions).

more direct measures of the historical pay-versus-performance relationship lack standardization and comparability, as discussed above. In this vein, the introduction of quantitative analyses of pay-versus-performance alignment by the major proxy advisory firms in recent years may be a sign of shareholder demand for additional computations regarding this relationship, beyond existing disclosures.[139]

The proposed amendments mainly require registrants to repackage in one location information that is disclosed in various other locations under existing rules. The anticipated benefits and costs of the proposed amendments are therefore driven by the impact that this additional format for presenting information may have on shareholders. The economic benefits and costs of the proposed amendments, including impacts on efficiency, competition and capital formation, are discussed below. We also discuss the relative benefits and costs of significant, reasonable implementation alternatives to the amendments as proposed.

1. Benefits

As discussed above, for the most part, the proposed amendments require a different presentation of certain existing information rather than the disclosure of new information. The primary benefits of the proposed amendments relative to the baseline will therefore depend on the extent to which the computations provided or the format used for the proposed disclosure is useful to shareholders.

Shareholders may benefit from the proposed amendments to the extent that the new presentation of data required by these amendments lowers their burden of analysis in

139 *See, e.g., supra* note 122.

evaluating the executive compensation policies of the affected registrants. Shareholders may evaluate executive compensation when making decisions relating to the say-on-pay vote and other votes relating to the compensation of the NEOs and the election of directors, as well as when making investment decisions. As part of this process, shareholders likely spend time and other resources to analyze current disclosures, including making computations that enable them to understand how compensation is related to performance. Existing disclosures regarding compensation are quite detailed, often lengthy, and, in some portions, subject to considerable variation. If the repackaging of some of this information into the required pay-versus-performance disclosure allows shareholders to more quickly or easily process the information accurately, the proposed amendments may generate efficiencies by preventing duplicative analytical effort by shareholders. Also, requiring that the disclosure be provided in a tagged data format may facilitate the extraction and analysis of any or all of this information across a large number of registrants or, eventually, across a large number of years. If the proposed disclosure is of interest to shareholders, it may be particularly beneficial to those shareholders who do not have access to third-party analyses, have fewer analytical resources, or are less adept at interpreting current disclosures on their own. If the disclosure helps shareholders process and understand compensation data faster, this information may also be more quickly incorporated in market prices, marginally increasing the informational efficiency of markets.

The size of this potential benefit depends on the extent to which the proposed disclosure approximates or contributes to any of the calculations and analyses that sophisticated shareholders would choose to perform on their own in order to process the existing disclosures, which is difficult to ascertain. The proposed requirement that registrants use standardized measures of compensation and performance would likely increase the comparability of disclosures specifically addressing the relationship of pay and performance relative to the broad variability under the baseline in the narrative discussion that may be provided in the CD&A and in voluntary pay-versus-performance disclosures.

To the extent that shareholders are interested in the prescribed measures, this enhanced comparability would likely enable more efficient processing of the information. In particular, standardization should reduce the time that shareholders would spend to learn what different measures represent: for example, once they understand what executive compensation actually paid reflects, they can understand what that measure means in other pay-versus-performance disclosures without having to examine each registrant's own definition. In addition, prescribing these measures reduces the ability of registrants to only disclose measures of pay and performance that lead to more favorable pay-versus-performance disclosures, which may allow shareholders to spend less time interpreting the choice of measures in the disclosure. Comparability may also allow shareholders to more easily evaluate a pay-versus-performance disclosure in the context of the pay-versus-performance disclosure of other registrants. Requiring disclosure of the annual values of the prescribed measures in a table should enhance such comparability of the disclosure across registrants by facilitating comparisons of the underlying content of the disclosures even when the format in which the relationship between the prescribed pay and performance measures is presented differs across registrants.

As noted above, these benefits of standardization would apply only to the extent that shareholders find the prescribed measures to be useful. Whether or not shareholders will be interested in the prescribed measures is unclear. For example, as discussed above, there are challenges associated with measuring an executive's contribution to registrant performance that may lead to concerns with any performance measure. However, TSR reflects information from a variety of underlying performance metrics, including market expectations of the future impact of current executive actions, and may thus be a useful metric in this context. While a registrant's own TSR as well as relative performance information will generally be available in Item 201(e) disclosures in annual reports for registrants other than smaller reporting companies, including peer performance in the pay-versus-performance disclosure may be useful to shareholders as it would enable them to evaluate the performance of a registrant relative to peers without requiring shareholders to refer to other disclosure documents.

Similarly, while the prescribed compensation measure would provide little incremental information beyond existing disclosures, the measure would reflect new required computations based on this existing data that may be particularly relevant in the context of evaluating the relationship of pay-versus-performance. These computations, and the tagging of the disclosure, may make information of interest to shareholders more readily available than it is under the baseline. For example, shareholders may be interested in the vesting-date valuations of options because academic studies indicate that changes in the value of equity awards after the grant date are a primary channel though which pay is linked to registrant performance.[140] For this reason, we believe that shareholders may be particularly interested in such post-grant changes in the value of equity awards when evaluating the relationship of pay-versus-performance. Shareholders may also be interested in the actuarial present value of benefits attributable to services rendered during a given year because these amounts may be more comparable to registrant contributions to defined contribution plans than the total change in actuarial pension value. The proposed adjustment with respect to pension plans is also expected to reduce the volatility in measured pension compensation caused by changes in interest rates and other actuarial assumptions, and should thus make it easier to evaluate the relationship of pay-versus-performance. Although shareholders could estimate the amounts proposed to be included in executive compensation actually paid with respect to equity awards and pension plans using existing disclosures, they may benefit from these computations becoming readily available in the prescribed compensation measure.

In addition, some shareholders may be interested in computing slightly different measures or using parts of the required computations for other purposes, in which case they are likely to benefit from the proposed footnote disclosure of the adjustments made to compute executive compensation actually paid and the disclosure of vesting date valuation assumptions, if materially different from the grant date assumptions. Also, as discussed above, requiring that the disclosure be provided in tagged data format may benefit shareholders interested in extracting and analyzing some or all of the data in the disclosure across a large number of filings.

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140 *See, e.g.*, Kevin J. Murphy, *Executive Compensation: Where We Are, and How We Got There*, (stating that studies show that virtually all of the sensitivity of pay to corporate performance for the typical CEO is attributable to the direct link between stock price performance and the CEO's portfolio of stock and options).

On the other hand, if the prescribed measure of executive compensation actually paid is significantly different from measures that shareholders would choose to construct on their own in order to evaluate compensation alignment, benefits may be limited and some shareholders may be confused by the disclosures, as discussed in more detail below. For example, the potential benefit of more efficient data processing is likely to be tempered by the fact that the proposed measure of executive compensation actually paid may be subject to substantial potential volatility due to its sensitivity to equity award vesting schedules, which may reduce the meaningfulness of relating the variation in the measure over time to stock price performance. Also, while tabular disclosure of the underlying data will provide some degree of comparability, benefits to shareholders may be either mitigated or enhanced by the proposed latitude in format for presenting the relationship between the prescribed pay and performance measures. The impact of this flexibility depends on whether the usefulness of more customized formats outweighs any added complexity in interpreting the disclosure and the reduction in comparability across registrants.

The proposed amendments could also have indirect benefits if the required disclosures lead to more optimal compensation policies, perhaps as a result of increased attention on the level or structure of NEO compensation and/or registrant performance. Specifically, if, by virtue of the disclosure, NEOs become less likely to demand, and/or boards become less likely to approve, a compensation level or structure that is not optimal (in that, as discussed above, it does not maximize long-term shareholder value),[141] then benefits will arise to shareholders and registrants. The resulting pay packages may represent either a benefit or a cost to the NEOs depending on whether or not the more optimal compensation structure, including the level of compensation as well as the risk exposure, is preferred by the executives.

The likelihood of such indirect effects is difficult to estimate because the ideal pay-versus-performance analysis for shareholders, as well as the optimal pay structure, is uncertain and may vary by company, and because reactions to the repackaging of information are difficult to predict. As discussed above, the proposed disclosure is intended to facilitate shareholders' consideration of the alignment between pay and performance when making related voting decisions. However, because the proposal does not require the disclosure of significant new information, and given high levels of existing attention to pay practices, we believe that it is unlikely that the proposed amendments would play a significant role in encouraging more optimal pay packages. We therefore believe that the proposed amendments are likely to have no material beneficial effects on competition or capital formation.

We believe that the only incremental information that the required disclosures under the proposed amendments would provide relative to existing public information is related to the calculation of option values as of the vesting date instead of the grant date. Registrants are also not currently required to disclose the actuarial present value of benefits attributable to services rendered during the applicable year, but they must disclose the pension plan terms and assumptions that could be used to compute this value.

[141] It is important to note that, as mentioned above, a closer link between executive pay and stock performance than the current status of compensation could be either beneficial or detrimental to firm value creation.

In contrast, while the valuation of options also involves certain assumptions, registrants are not currently required to disclose vesting-date valuation assumptions for option grants.

Using existing disclosures, shareholders can themselves make estimates of the vesting-date values based on the disclosed option terms, by using publicly available data to make reasonable valuation assumptions.[142] A vesting-date valuation provided directly by the registrant would reflect its discretion in choosing a valuation methodology and estimating the inputs required, particularly the expected option life and the expected volatility of the stock.[143] The grant-date valuations provided by registrants already demonstrate, to some extent, how the registrants choose to apply their discretion in the valuation process.[144] It is unclear to what extent shareholders would find the additional disclosure of a vesting-date valuation, which would similarly reflect registrant discretion, to provide meaningful new information. Also, shareholders may be concerned that such discretion could be used to understate compensation actually paid, affecting the reliability of registrant valuations. We therefore believe that the potential benefits of the proposed

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142 Such data might include financial statement footnote disclosures relating to significant assumptions made by the registrant in arriving at disclosed grant-date valuations and information regarding the past exercise behavior at the registrant or a broader group of firms, as well as market information on bond and dividend yields and stock price volatilities.

143 While FASB ASC Topic 718 requires that the assumptions used shall not represent the biases of a particular party, there will generally be a range of assumptions that could be considered to be reasonable, and so the choice of particular assumptions will reflect registrant discretion.

144 An academic study of executive compensation among firms in the S&P 1500 from 1996 to 2001 found that the grant-date valuations of option awards by these registrants were, on average, understated. However, because this paper uses data from 1996 to 2001, it might not accurately reflect current practices. *See* David Aboody, Mary E. Barth and Ron Kasznik, *Do Firms Understate Stock-Based Compensation Expense Disclosed under SFAS 123?* 11 REV. OF ACC. STUD., No. 4, 429 (2006). Notably, when evaluating executive compensation, two major proxy advisory firms each use their own, standardized set of methodologies and assumptions to value option grants rather than relying on each registrant's estimate of grant-date value. *See, e.g.*, http://www.issgovernance.com/policy/ExecutiveCompensationFAQ, and http://www.glasslewis.com/issuer/stock-option-model-details.

amendments derive primarily from the manner in which the information is presented rather than the disclosure of any significant new information.

2. Costs

We believe that the costs to registrants of complying with the proposed amendments likely would be relatively low, given that the required disclosures do not require the collection of any significant new information relative to the baseline and the required additional computations are straightforward. The valuation of options as of a different date and the required computations with respect to pension plans can be accomplished by entering new inputs into the existing valuation models used to calculate currently disclosed values. These costs will also be limited by phasing in the time periods for the disclosure for both new and existing registrants, thereby reducing the computations required when first producing the disclosure, and phasing in the tagging requirement for smaller reporting companies. The primary costs of complying with the proposed amendments include the time and expense to make the required computations, to design and apply a format for the disclosure, to apply XBRL data tagging, and to ensure appropriate review, such as by management, in-house counsel, outside counsel and members of the board of directors. As discussed above, registrants would be required to file the pay-versus-performance disclosure in certain proxy or information statements. While much of the disclosure would be based on information that is otherwise disclosed, the new computations and new presentation of this underlying information, as well as the inclusion of existing measures -- TSR and peer group TSR -- that are otherwise "furnished" but not "filed," may create an incremental risk of litigation under Section 18 of the Exchange Act. However, we note that Section 18 does not create strict liability for "filed" information.[145]

The compliance costs are likely to vary somewhat among registrants depending on the complexity of their compensation structures. For example, the computation of executive compensation actually paid from total compensation reported in the Summary Compensation Table involves adjustments to the treatment of equity awards and pension benefits. As shown in the baseline section above, while a relatively higher proportion of large companies have pension plans and grant stock and option awards to executives, a significant fraction of mid-sized and smaller companies feature these components in their compensation plans as well. Thus, while the compliance costs are likely to be low, these costs may be slightly more burdensome for those affected registrants which have complex compensation packages and are small enough that the costs of the disclosure are relatively more consequential in comparison to their size. Smaller reporting companies would be subject to scaled requirements consistent with their existing disclosure requirements, including fewer years of disclosure, no requirement to report peer group performance, and the exclusion of items related to pension plans in computing executive compensation actually paid. Smaller reporting companies are not currently required to comply with Item 201(e), so they may face a small incremental burden of computing their own TSR for the purpose of this disclosure as compared to other affected registrants.

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[145] *See* Exchange Act Section 18 [15 U.S.C. 78r]. A plaintiff asserting a claim under Section 18 would need to meet the elements of the statute to establish a claim, including purchasing or selling a security in reliance on the misstatement, and damages caused by that reliance.

Based on analysis for purposes of the Paperwork Reduction Act ("PRA"), as discussed in Section V of this release, we estimate that the total incremental burden on all registrants of the proposed amendments would be, annually, 67,500 hours for internal company time, and $9,000,000 for the services of outside professionals. Certain registrants – such as those that have infrequent equity grant vesting dates or other compensation structures that result in a more volatile measure of executive compensation actually paid – may be more likely to voluntarily supplement the disclosure with additional measures, explanations, or analyses in order to explain the patterns in the required disclosure, and may thus face higher overall costs. However, we do not believe that any of the variation in the compliance burden will be large enough to have a material detrimental effect on competition or capital formation.

Shareholders may bear additional information processing costs as a consequence of the proposed amendments if they increase the length and complexity of existing disclosures without significantly adding to the ease of interpretation. The likelihood and extent of such costs may be a function of the potential confusion resulting from the proposed disclosure, as discussed in more detail below, and the related increase in supplementary disclosures that may result, as well as the complexity of and variation in presentation formats, as discussed above. If the proposed disclosure were to confuse rather than help shareholders and therefore complicate the task of understanding executive pay policies, it may marginally decrease the informational efficiency of markets.

The proposed amendments may confuse shareholders about the optimality of pay practices if it brings attention to a particular relationship that may not be meaningful in the context of a given registrant. As discussed above, there are challenges in measuring pay-versus-performance alignment which are likely to impact any standardized approach to presenting this relationship. Including peer group performance in the disclosure may help shareholders to identify when registrant performance could be driven by market moves, sector opportunities, commodity prices, or other factors unrelated to managerial effort or skill. However, the proposed disclosure may be less meaningful if the disclosed performance, even relative to peers, is different from the contribution of the given NEO to performance, or if the disclosed relationship between compensation and performance does not (because of timing considerations or vested equity holdings) accurately capture the economic relationship between the company's performance and the financial rewards to the NEO.

In addition to the general concerns raised above, the proposed definition of executive compensation actually paid may be particularly subject to volatility based on the vesting pattern of equity awards, because the measure includes in the year of vesting the original grant-date value and all gains (or losses) related to returns in all years since the grant was made. In particular, the proposed measure is likely to increase sharply in any year during which significant equity awards vest, and gains or losses on equity awards are likely to be reflected in different years than the stock performance that generated them. Such volatility could make it difficult to understand the relationship, or lead to incorrect inferences about the relationship, between pay and performance.

The treatment of equity awards may also reduce the comparability of the compensation measure across registrants. The exclusion of grant date values in the year of grant may make it difficult to compare the total value of compensation packages. For example, for a given fiscal year, if one PEO is paid $1 million in cash and another PEO is paid $1 million in restricted stock that vests after one year, the executive compensation actually paid for the year will be $1 million in the first case and zero in the second case. This measure would be accompanied in the proposed tabular disclosure by the Summary Compensation Table measure of total compensation, which reflects the grant date values of equity awards, and may thus contribute to a more complete view of a compensation package. However, the reduced comparability resulting from the exclusion of the grant date values of equity awards from the proposed measure may still complicate the task of interpreting the disclosure.

The sensitivity of the proposed measure of executive compensation actually paid to vesting schedules may also reduce comparability. For example, consider two NEOs who are granted large, one-time awards of restricted stock that vest in full after one year, but with vesting dates that are one day apart – on the last day of a fiscal year versus the first day of the next fiscal year. The pattern in compensation actually paid may look very different for these two executives because the award of stock will be reflected in different years.

The potential for confusion is particularly of concern given that the proposed disclosure may be of most interest to less sophisticated shareholders, who may be less likely to have access to third-party pay-versus-performance analyses or may be less adept at conducting their own such analyses. The possibility of confusion is mitigated by allowing registrants to provide supplemental measures of pay and performance in the proposed disclosure, as well as the ability of registrants to provide further explanatory disclosures (such as in the CD&A for affected registrants other than smaller reporting companies). However, such clarifying disclosures may be more likely to be provided when the proposed disclosure is perceived by the registrant to incorrectly indicate the misalignment of pay and performance than when the proposed disclosure is perceived to incorrectly indicate strong alignment.

The proposed amendments could also lead to indirect costs if the required disclosures lead to changes in compensation packages that are not beneficial. Registrants may make changes to avoid disclosure that they perceived to correctly or, because of the limitations of the standardized approach, incorrectly indicate the misalignment of pay-versus-performance. For example, by virtue of the disclosure, boards may become more likely to approve compensation structures that more strongly link pay to stock price performance, even in situations in which this would not be optimal.[146] More subtle changes in compensation structures may also be made to improve the appearance of pay-versus-performance alignment. For example, registrants may choose to apply shorter or more graduated equity award vesting schedules to generate a less volatile measure of executive compensation actually paid. However, such changes in the design of compensation packages could harm shareholder value creation by, for example, placing more than the optimal weight on short-term performance.[147] Thus, if such changes are indirectly encouraged by the proposed amendments, they may entail costs to registrants and their shareholders. The resulting pay packages may represent either a benefit or a cost to the NEOs depending on whether or not the less optimal compensation structure,

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146 *See supra* notes 135 and 136 regarding academic studies that find that a stronger link between pay and stock price performance may not be optimal.

147 *See, e.g.*, Alex Edmans, Vivian Fang and Katharina Lewellen, *Equity Vesting and Managerial Myopia,* NBER Working Paper No. 19407, (Sept. 2013), *available at* http://www.nber.org/papers/w19407.

including the level of compensation as well as the risk exposure, is preferred by the executives.

As in the case of the potential benefits outlined above, many of these costs are difficult to quantify because the ideal pay-versus-performance analysis for shareholders, as well as the optimal pay structure, is uncertain and may vary by company and because reactions to the repackaging of information are difficult to predict. Still, because the proposal does not require the disclosure of significant new information, and given high levels of existing attention to pay practices, we believe that it is unlikely that the proposed amendments would play a significant role in encouraging poor pay practices. We therefore believe that the proposed amendments likely would have no material detrimental effects on competition or capital formation.

3. Implementation Alternatives

In this section, we present significant implementation alternatives that have been considered and a discussion of their benefits and costs relative to the amendments as proposed.

a. Registrants and Filings Subject to the Disclosure

An alternative to the amendments as proposed would be to require that pay-versus-performance disclosure would accompany any Item 402 disclosure, including in Form 10-K or Form S-1. Such an approach would make pay-versus-performance disclosures more consistently available for Section 12(g) registrants subject to the amendments and broaden the disclosure requirement to include Section 15(d) registrants other than emerging growth companies. As discussed above, we believe that the proposed disclosure would be most useful to shareholders when they are deciding whether to approve the compensation of the NEOs through the say-on-pay vote, voting on the election of directors or acting on a compensation plan. The proposed approach would require pay-versus-performance disclosure in proxy statements in each of these cases. Nonetheless, shareholders making voting decisions at a particular registrant may benefit from broader and more consistent availability of pay-versus-performance disclosures on an annual basis at other registrants. Specifically, these disclosures may allow shareholders to more easily compare pay practices across registrants when deciding how to vote at a particular registrant, particularly, for example, in the case of smaller companies whose peers may be more likely to be Section 12(g) or Section 15(d) registrants. Such disclosures may also be of use to some shareholders in making investment decisions, irrespective of any matters that are up for a vote.

However, registrants with reporting obligations only under Section 12(g) or Section 15(d) do not have securities that are registered on national securities exchanges, so the markets for their shares are likely to be comparatively less liquid. Estimates of share values and therefore of total shareholder return for such registrants may be less precise and less readily available, potentially making pay-versus-performance comparisons based on this metric less meaningful across such registrants. Also, as in the case of smaller reporting companies, Section 15(d) registrants are not subject to Item 201(e) requirements for stock price performance disclosure. Similarly, Section 12(g) registrants may not be required to disclose Item 201(e) information in some or all years, so Section 15(d) registrants and some Section 12(g) registrants would bear an additional burden of calculating their own TSR and, except in the case of smaller reporting companies, the TSR of a peer group for this purpose.

An alternative that would narrow the applicability of the disclosure would be to exempt smaller reporting companies from the proposed disclosure requirement. Exempting smaller reporting companies generally would be consistent with the overall scaled disclosure requirements that apply to smaller reporting companies. While the proposal would subject smaller reporting companies to scaled requirements in order to limit the incremental burdens such companies may face relative to other registrants, some such burdens remain. For example, smaller reporting companies are currently not required to disclose their TSR in annual reports, so they would face a higher burden than other registrants to include this measure in the pay-versus-performance disclosure. We note, also, that requiring only a scaled version of the pay-versus-performance disclosure for smaller reporting companies may limit the benefits to shareholders by reducing the content and comparability of the disclosures. Also, in the absence of CD&A disclosure, shareholders would have less information with which to interpret pay-versus-performance disclosures from these registrants.

On the other hand, it is possible that some shareholders may benefit from the proposed pay-versus-performance disclosure for these registrants, particularly because these registrants currently provide less extensive disclosure about compensation and the data that they do disclose is unlikely to be available in aggregate form from data vendors that collect such data from the proxy statements of larger companies. For example, shareholders who believe that the long-term performance of younger, high growth companies may be particularly sensitive to the design of compensation structures may benefit from smaller reporting company pay-versus-performance disclosures, even if these disclosures are not directly comparable with the disclosures of other affected registrants. Shareholders that are interested in comparing executive compensation across smaller reporting companies would benefit from this data being tagged, particularly because of the lack of commercial databases collecting executive compensation information for such registrants. The proposal would permit smaller reporting companies to present fewer years of information in the disclosure, to not include peer group performance, and to exclude items related to pension plans in computing executive compensation actually paid. While the scaled requirements for smaller reporting companies may limit the potential benefits to shareholders interested in executive compensation at such registrants, these scaled requirements should substantially limit the incremental burdens faced by smaller reporting companies in providing pay-versus-performance disclosure.

b. Disclosure Requirements

We have considered several reasonable alternatives to the proposed disclosure requirements.

Some commenters recommended a more principles-based approach that would permit registrants to determine which measures of pay and performance to disclose and how to disclose the relationship between these measures based on what they deem to be appropriate for their individual situations.[148] Such an approach could have the potential to allow shareholders to more directly observe how management views the alignment of pay and performance at a given registrant, and might reduce reporting costs because registrants need only report what they believe to be appropriate given their unique circumstances. To the extent that the prescribed measures may be less meaningful at

[148] *See* letters from SCSGP, ABA, CEC I, ClearBridge, Protective Life, and Davis Polk.

particular registrants, a principles-based approach could reduce shareholder confusion in understanding the relationship between pay and performance at a particular registrant. A principles-based approach would also reduce the risk that the disclosure requirements could lead registrants to change their compensation structures in ways that are less than optimal for the sake of achieving what they perceive to be more favorable pay-versus-performance disclosure. However, such an approach may reduce comparability of the disclosure across registrants and could increase shareholder confusion because the choice of pay and performance measures, and the disclosure horizon, may vary significantly. Also, a principles-based approach may allow registrants to selectively choose the measures or horizon that result in the most favorable disclosure. The proposed approach of specifying some uniform requirements for the disclosure and permitting supplemental disclosure should promote comparability while preserving flexibility to tailor the disclosure to a registrant's individual situation.

In particular, the proposed disclosure promotes a level of comparability by requiring standardized measures of compensation and performance that are consistent across registrants. Similarly, the proposed requirement that the disclosure cover, at minimum, a five-year (three-year for smaller reporting companies) time period after the initial phase-in should also increase the comparability and usefulness of the disclosure compared with the alternative of allowing the registrant to potentially choose a shorter time period for disclosure. Registrants will be permitted to present supplemental measures of compensation and performance and additional years of data in the pay-versus-performance disclosure, will have flexibility as to the format in which to present the relationship between pay and performance, and will continue to have significant latitude in presenting additional compensation analyses (such as in the CD&A, for affected registrants other than smaller reporting companies), all of which should help registrants to clarify their unique circumstances and considerations in evaluating compensation.

Conversely, we also have considered increasing the comparability of pay-versus-performance disclosures by prescribing a uniform format or some minimum requirements for the presentation format of the relationship. Under the proposal, registrants may apply a wide range of formats when presenting the relationship between the measures that might not be directly comparable, particularly as some registrants may present the relationship between the prescribed measures using percentage changes or ratios while others may present the levels of these measures. However, the tabular disclosure of the annual values of executive compensation actually paid and registrant and peer group performance should allow shareholders to compare the content of the disclosures across registrants using different formats. Still, shareholders' ability to easily compare the disclosure across registrants may be further increased by requiring a uniform format for presenting the relationship, such as a standardized graphical presentation, or some minimum standards for the presentation format, such as a requirement that the disclosure be in the form of a graph. The cost of these more prescriptive approaches would be the restrictions on the ability of registrants to tailor the format of the required disclosures to best reflect their individual circumstances, which may vary significantly.

A further alternative would be to require registrants to provide an analysis of the presented information in narrative accompanying the factual disclosure. For example, registrants could be required to explain which compensation decisions or which elements of compensation, if any, were most responsible for the patterns in the presented relationship between executive compensation actually paid and total shareholder return. Such supplementary analysis may help shareholders to interpret the disclosures, particularly in cases where, as discussed above, the presented relationship may be distorted by issues such as timing mismatches and factors unrelated to managerial performance that may affect stock prices. The proposed amendments permit such explanations to be provided on a voluntary basis but, as discussed above, such clarifying disclosures may be more likely to be provided when the proposed disclosure is perceived by the registrant to incorrectly indicate the misalignment of pay and performance than when the proposed disclosure is perceived to incorrectly indicate strong alignment. However, making the provision of such narrative disclosure mandatory may increase the compliance burden and might suggest that the registrant considered, or should consider, the pay-versus-performance relationship in its compensation decisions.

We have also considered increasing or decreasing the minimum information required to be included in the disclosures. With respect to increasing the minimum information, we considered requiring the inclusion of additional measures of pay or performance or requiring that the disclosure cover a longer time period. Shareholders may find expanded disclosures to be beneficial. For example, a longer time period (e.g., the entire service period of the executive)[149] for the disclosure may provide shareholders with additional context with which to evaluate the disclosure. In particular, requiring a longer horizon may help shareholders to understand timing mismatches that the disclosures may be subject to, as discussed above, by increasing the likelihood that the

[149] *See* letter from CII.

disclosures include pay (or performance) that may appear in a different time period than the corresponding performance (or pay). Mandating the inclusion of additional measures of pay and performance (such as relative pay measures and accounting measures of performance) may increase the usefulness of the disclosure in some cases by summarizing more information that could be relevant in evaluating pay versus performance alignment. Also, requiring more years of data or more prescribed measures may increase the comparability of the disclosures if, under the proposed requirements, some but not all registrants choose to provide such additional information.

However, such extended requirements would impose a higher compliance burden while potentially requiring registrants to include information that they do not believe to be relevant to their circumstances, and/or which shareholders may not find to be relevant. Also, requiring additional measures may also make the disclosure of the relationship between pay and performance more difficult to process quickly, while not adding to the total amount of underlying information available to shareholders from public disclosures.

With respect to decreasing the minimum required information, we also considered reducing the required disclosure period to three years, excluding Summary Compensation Table total compensation from the required tabular disclosure, or not requiring TSR for a peer group. On the one hand, these alternatives could reduce the compliance burden on registrants by limiting the total amount of information that would need to be included in pay-versus-performance disclosures, while continuing to provide flexibility to registrants to include additional information if they find it to be appropriate. On the other hand, decreasing the minimum required information could reduce the benefits to shareholders discussed above and may not substantially reduce compliance costs given that, for example, the excluded information would generally still be required to be disclosed in other years, other parts of the proxy or information statement, or other filings. Overall, we believe that the proposed minimum required information appropriately balances a level of comparability and usefulness against the costs of complying with the requirements of pay-versus-performance disclosure.

One commenter[150] recommended that registrants subject to the amendments be required to present relative pay compared to relative performance, each measured with respect to a group of peer companies. While performance information for a peer group would be required to be included under the proposal, also incorporating pay information for a peer group in order to produce relative pay-versus-performance disclosures may be useful to shareholders as it would provide further context in which to evaluate the pay-versus-performance alignment of a registrant. Using a relative approach would also permit the relationship of pay and performance to be presented across registrants using, for example, an aggregate three-year compensation measure, rather than the relationship being presented across time for an individual registrant using annual measures.[151] The use of aggregate measures, recommended by several commenters, may reduce the potential timing mismatches and volatility in executive compensation actually paid.[152] However, requiring further comparisons to a peer group may reduce the comparability of

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[150] *See* letters from SVA.

[151] Aggregating compensation over a three-year period would result in a single number representing executive compensation actually paid for this full period. Such aggregation would thus make it impossible to demonstrate the relationship between pay and performance over time, and so this relationship could only be demonstrated across another dimension, such as across peers. The proposed amendment requires the use of an annual measure so that registrants can present the relationship of pay and performance over time at the particular registrant.

[152] *See* letters from ClearBridge, Pay Governance, and SVA.

disclosures because of registrant discretion in selecting the peer group or variation in the availability of a closely comparable peer group. There are also practical implementation considerations, as peer compensation for the last fiscal year is not likely to be available at the time a registrant is compiling the disclosure. Further, even if these practical considerations could be mitigated (e.g., by permitting peer information to be excluded when unavailable), requiring relative pay-versus-performance would most likely impose higher compliance costs.

Requiring peer performance but not peer compensation information as in the proposal should help shareholders to understand when registrant performance could be driven by market moves, sector opportunities, commodity prices, or other factors unrelated to managerial effort or skill. Under the proposed amendments, registrants that prefer to include information about peer pay-versus-performance will be permitted to present relative measures of pay and alternative measures of relative performance as additional measures in the pay-versus-performance disclosure and will continue to have the ability to present relative compensation analyses in the CD&A. Because registrants might only choose to present this information when they perceive the comparison to peers to appear favorable, allowing such voluntary disclosure would not provide the full benefits of mandating relative pay-versus-performance disclosure. However, shareholders could also construct relative pay-versus-performance analyses on their own by comparing the separate pay-versus-performance disclosures of each of a registrant's peers, based on the peer group reported by a registrant under Item 201(e) or in the CD&A.

Another commenter recommended that the pay-versus-performance disclosure be limited to the PEO's compensation.[153] This alternative may focus the disclosure on the information that is likely to be of most interest to shareholders. Also, as discussed above, the contribution of NEOs other than the PEO to firm performance is less likely to be adequately measured by overall registrant performance statistics such as the TSR. This alternative would marginally reduce compliance costs as compared to requiring disclosures regarding the average compensation of the other NEOs as proposed. However, limiting the disclosure to the PEO may also reduce the benefits to shareholders, to the extent they would use the proposed disclosures to evaluate the compensation of the other NEOs.

We could require pay-versus-performance disclosure for each individual NEO, rather than or in addition to the average of the other NEOs as a group. Disclosure with respect to the individual NEOs could be required only in the required tabular disclosure of the prescribed measures or in both the disclosure of these measures and in the disclosure of the relationship between the measures. Such approaches would allow shareholders to more directly compare pay-versus-performance for NEOs with the same or similar titles across different registrants. Also, some shareholders may be interested in the pay-versus-performance alignment of particular NEOs other than the PEO and would thus benefit from such individual disclosures. Since the computations required to produce individual disclosures would already be made in order to produce disclosure on an average basis for all of the NEOs, the incremental burden of producing such individual disclosures may be low.

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153 *See* letter from Meridian.

However, while some shareholders may be interested in such disclosure, variability in the composition and number of other NEOs over the horizon of the disclosure may complicate the interpretation of the relationship between pay and performance over the years for which disclosure is required. The roles of individual NEOs might not be comparable, and their titles might not be consistent, across registrants, limiting the benefits to shareholders interested in comparing pay alignment for particular roles across registrants. Also, firm-level performance measures may be less likely to adequately measure an NEO's contribution to a registrant's performance than that of the PEO, given the more focused roles (such as division head or chief technology officer, among many other possibilities) of individual NEOs, so individual disclosures for the NEOs could be of limited benefit in many cases. Because of these limitations, and the increase in the length and complexity of the disclosure required to present individual NEO information, requiring pay-versus-performance disclosures for each individual NEO could increase the time required for a shareholder to analyze and process the information and increase the likelihood of shareholder confusion.

We are proposing to require XBRL tagging of the disclosure because some shareholders may be interested in extracting and analyzing the information in the table across large numbers of registrants or, eventually, a large number of years, and would thus benefit from the proposed tagging requirement.[154] The proposal would require registrants to tag the numerical data disclosed in the required table, and to separately

[154] Some shareholders that are interested in analyzing compensation data across a large number of filings may also wish to analyze the substantial amount of other information regarding compensation in the proxy statement. Because this other data is not currently provided in an interactive data format, such shareholders would have to continue to purchase such data from a data vendor that aggregates this data or to electronically parse or hand-collect such data from filings. The incremental benefit of the proposed data tagging requirement is likely to be lower for such shareholders than for those primarily interested in the data proposed to be tagged.

block-text tag, as three blocks, the disclosure of the relationship among the measures, the disclosure of deductions and additions used to determine executive compensation actually paid, and the disclosure regarding vesting date valuation assumptions. We have considered alternatives with respect to the proposed XBRL tagging requirement, including not requiring that the underlying data disclosed in tabular form be provided in an interactive data format, requiring more or less of the information to be tagged, allowing supplementary information to be tagged, or requiring a different tagging format.

The affected registrants are familiar with data tagging because they are required to provide information in other filings in interactive data format, but the exact specifications differ and they are not required to provide any interactive data in proxy or information statements.[155] Requiring an interactive data format would impose additional costs and burdens on registrants, beyond what they currently spend on producing interactive data for other purposes, because their contracts with outside data tagging vendors and/or the responsibilities of their in-house staff that works on data tagging would have to be expanded to include the new tagging requirement. Despite these costs, some shareholders may benefit from the data tagging requirement to the extent that it is helpful in extracting the tagged data across large numbers of filings.

We considered not requiring registrants to tag, as a block, the graphical and/or narrative disclosure that would follow the tabular disclosure. While the nature and potential variation in format of this disclosure may make it less suitable for large-scale analysis than the numerical data required to be tagged under the proposal, the incremental

155 Business development companies are not currently required to provide their financial statements and financial statement footnotes in XBRL format, and may thus be less familiar with data tagging than other registrants. We estimate that there are approximately 13 business development companies that would be subject to the proposed amendment.

costs of tagging this disclosure as block-text should be low and such tagging could benefit shareholders interested in extracting this part of the disclosure from a large number of filings. We also considered not requiring registrants to tag, as blocks, the disclosures of deductions and additions used to determine executive compensation actually paid and the disclosure regarding vesting date valuation assumptions. The cost of block tagging these disclosures should be low and shareholders interested in this information may find such tagging to be useful. Alternatively, we could require that each numerical item in the deductions and additions used to determine executive compensation actually paid and the vesting date valuation assumptions be tagged separately. While such tagging may benefit shareholders interested in using this data, it would require some incremental compliance costs. Another alternative would be to allow registrants to tag any supplemental measures of pay and performance that they include in the disclosure beyond the prescribed measures. While some shareholders may benefit from such tagging, the supplemental measures included, if any, are likely to vary across registrants and such data may thus be less suitable for large-scale analysis than the prescribed measures.

We also considered requiring registrants to provide the data in XML format rather than XBRL. An XML format could be appropriate given the fixed structure of the proposed tabular disclosure and would permit the use of existing EDGAR applications that can convert submitted information to XML. This could increase the ease with which registrants could implement the structured formatting requirement, and could thus reduce costs, particularly for smaller registrants. However, XBRL is more appropriate for capturing information that is not well suited for tabular disclosures; in particular, standard

XML is not able to tag large blocks of information without customization, whereas this function is standard in XBRL. XBRL is therefore more suitable for implementing the proposed requirements for block tags. In determining to propose a requirement to tag the data in XBRL format as opposed to XML format, we also considered the fact that XBRL allows for more flexibility to implement, for example, potential extensions to the data to be tagged as discussed above.

c. Definition of Executive Compensation Actually Paid

We have also considered several reasonable alternatives for the definition of executive compensation actually paid.

Incremental Compensation Earned

One approach would be to define "executive compensation actually paid" as the incremental compensation earned by an executive in a given year over those amounts that had already been earned in previous years. In this case, executive compensation actually paid would, as in the proposed measure, include all of the components included in the Summary Compensation Table (such as salary and cash bonuses) but with adjustments to the amounts included for equity awards and pension plans. In contrast to the proposal, the measure based on the incremental compensation earned would include in a given fiscal year the grant-date values of any new equity awards granted that year together with the annual change in value (whether positive or negative) of any outstanding, unvested option and stock grants. The change in values of these grants would be included in each fiscal year until their vesting date. In the case of options, these changes in value would be measured by applying the registrant's chosen option valuation methodology (*e.g.*, Black-Scholes or lattice valuation). This treatment of equity awards is similar to an approach used by one commenter.[156]

The corresponding treatment for pension plans would be to include the present value of those benefits that were earned in the last fiscal year, which may differ from the actuarial present value attributable to services rendered during the applicable fiscal year. In particular, the latter may be based on estimates of future benefits that include the impact of assumptions about future levels of compensation. The former, on the other hand, is intended to capture the present value of the impact on future benefits that can be directly linked to the change in inputs to the benefit formula (including compensation levels as well as years of service) over the last fiscal year.

A potential benefit to shareholders of applying these alternative adjustments to equity and pension plans in presenting executive compensation actually paid is that, with respect to equity awards, it would reduce the volatility in executive compensation actually paid, which, as discussed above, could reduce the comparability of the disclosures and the meaningfulness of relating the variation in the compensation measure over time to stock performance. In particular, this alternative approach would limit the value attributed to equity-based awards in any year to the change in value that is directly related to the stock return over that year, rather than including in the year of vesting the gains related to returns in all years since the grant was made. This approach may therefore allow shareholders to more readily interpret the relationship between variation in the compensation measure over time and stock performance. It may also reduce the

[156] *See* letter from J&J.

unintended, indirect encouragement of shorter or more graduated vesting schedules in order to smooth executive compensation actually paid under the proposed definition.

In addition, this alternative approach would limit potentially significant differences in the measured executive compensation of registrants that provide very similar equity awards but with vesting schedules that are not synchronized. As discussed above, if two NEOs receive one-time awards of restricted stock that vest in full after one year, but with vesting dates that are one day apart – on the last day of a fiscal year versus the first day of the next fiscal year – the proposed approach would reflect the full value of the award in different years for the two NEOs. The alternative approach based on the incremental compensation earned would reflect any change in the value of each award over a given fiscal year in that same fiscal year, generally resulting in a more similar annual measure of compensation for the two NEOs in this example than the proposed measure.

Finally, including the value of equity awards at the grant date and then reflecting changes in this value in the years until vesting would increase the comparability of the disclosures across registrants that rely on equity awards to different extents while still demonstrating the performance sensitivity of unvested equity awards. For example, consider the example above, in which, for a given fiscal year, one PEO is paid a $1 million salary in cash and another PEO is paid $1 million in restricted stock that vests after one year, each of which comprises their total compensation. In contrast to the proposed approach, which would reflect executive compensation actually paid of $1 million and zero, respectively, for the two executives in that year, this alternative would reflect the same level of compensation for the two PEOs in that year, while still presenting any changes in the value of the second PEO's stock grant over the next year. It is important to note that these changes in value could be negative. For example, if the price of the stock granted to the second PEO were to fall significantly thereafter, or if the vesting conditions were not satisfied, this alternative approach could result in a large negative adjustment to that PEO's executive compensation actually paid in the year of such price change or failure to vest.

With respect to pensions, this alternative approach would provide a measure of future benefits that may be more directly tied to changes over the last fiscal year. Pension benefits may be a function of compensation levels, as in the case of pay-related, final-pay, final-average-pay, or career-average-pay plans. In the proposed approach, the values included for pensions are based on estimates that may already incorporate projections about future compensation levels. As a result, the effect of actual changes in current compensation levels on the value included for pensions in the proposed measure may be dampened. Because actual changes in current compensation may be related to performance, and these changes in compensation may be magnified by pension benefits that are a function of compensation levels, the alternative approach may be more useful in evaluating the relationship between pay and performance. The alternative approach may also further increase the comparability between compensation provided through defined benefit and defined contribution plans, since registrant contributions to defined benefit plans may also be directly related to current compensation levels or other such metrics with respect to the last fiscal year.

However, interpreting compensation "actually paid" as the incremental compensation earned by an executive in a given year would increase the reporting burden for registrants, because equity awards would have to be revalued in each year from the grant date until the time of vesting, rather than only at the grant date (for the purpose of the Summary Compensation Table and related disclosures) and at any vesting dates (for the purpose of the proposed pay-versus-performance disclosure). Also, the calculations to be made with respect to pensions may be less directly related to the values already calculated for the purpose of financial statement reporting, and could therefore be more burdensome. Overall, this approach may provide some benefits but could result in additional costs.

Other Alternative Definitions

Some commenters suggested excluding components of pay that may be considered to be unrelated to performance – such as perquisites, values related to retirement benefits, or even base salaries – from the definition of executive compensation actually paid.[157] We believe that restricting the definition of executive compensation actually paid in such a way would not provide shareholders with a complete understanding of compensation and how it relates to financial performance. While compensation committees may rely mainly on particular components of compensation in order to provide performance incentives, other components of compensation (such as

[157] *See* letters from CEC II (recommending that the measure exclude one-time special make-whole awards because they are non-performance-based), Compensia (recommending that the measure only include items that "are paid and awarded based on the financial performance of the company," which are listed as amounts paid under both short-term and long-term incentive compensation plans and performance-based equity awards for which the performance measures are based on financial criteria), Cook (recommending that that measure exclude changes in actuarial pension value, above-market earnings on deferred compensation, and the All Other Compensation category "because these figures have nothing to do with performance"), Davis Polk (recommending that the measure only include "items that an issuer believes are based in some measure on attainment of company performance objectives" and exclude items such as pension accruals, deferred compensation earnings, issuer contributions to tax-qualified and non-qualified deferred compensation plans and perquisites and welfare benefits), and Foley (recommending that the measure reflect "performance-based pay (with or without base salary added in).")

perquisites, registrant contributions to defined contribution plans, and life insurance premiums paid by the registrant) may or may not vary with company performance and, even if they do not vary with performance, may be important to consider in order to understand how sensitive the totality of compensation is to performance. Restricting the types of compensation included in executive compensation actually paid may also reduce the comparability of disclosures across registrants that rely more heavily on types of compensation that are excluded from the prescribed measure versus those that rely more heavily on compensation types that are included.

The proposal would require registrants to include the Summary Compensation Table measure of total compensation together with executive compensation actually paid in the tabular disclosure of pay and performance measures, but some commenters have suggested that executive compensation actually paid also be defined to be more similar to this existing measure. For example, four commenters supported the use of grant-date values for equity awards in executive compensation actually paid.[158] Such an approach would reduce the costs of compiling the required disclosure and would result in a compensation measure that, because of its comprehensiveness, would be reasonably comparable across registrants. However, this approach would not reflect the performance sensitivity of unvested equity awards. As discussed above, because academic research has demonstrated that the empirical relationship between pay and performance is driven by changes in the value of executive stock and option holdings, considering only grant-date values may ignore one of the primary channels for relating pay and performance.[159]

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158 *See* letters from Compensia, Cook, MDU, and Meridian.

159 *See supra* note 140.

We note that this concern was raised by one commenter.[160] Some commenters have also suggested that the definition of executive compensation actually paid follow total compensation in its approach to pension plans, by including the total change in actuarial pension value in the measure.[161] As in the case of the treatment of equity awards, mirroring the approach in total compensation in this way would reduce compliance costs. However, this alternative would introduce additional volatility to the compensation measure for registrants whose NEOs have large pension balances, as the actuarial values of the previously accumulated benefits are likely to be strongly impacted by factors such as changes in interest rates.

D. Request for Comment

Throughout this release, we have discussed the anticipated costs and benefits of the proposed amendments. We request and encourage any interested person to submit comments regarding the proposed amendments and our analysis of the potential effects of the amendments. We request comment from the point of view of registrants, shareholders, and other market participants. With regard to any comments, we note that such comments are particularly helpful to us if accompanied by quantified estimates or other detailed analysis and supporting data regarding the issues addressed in those comments. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we have overlooked.

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160 *See* letter from SCSGP.

161 *See* letters from MDU and SVA.

55. We seek comment and data on the magnitude of all of the costs and benefits identified as well as any other costs and benefits that may result from the adoption of the proposed amendments. In addition, we seek views regarding these costs and benefits for particular types of covered registrants, including small registrants, and for particular types of shareholders.

56. Would the proposed disclosure facilitate shareholders' evaluation of a registrant's executive compensation practices? Are there alternative definitions of executive compensation actually paid and financial performance, or other types of computations or compensation data, which would be more useful to shareholders in evaluating pay-versus-performance alignment, while still satisfying the mandate of Exchange Act Section 14(i)? Would limiting the applicability of the amendments to PEO compensation rather than that of all NEOs affect the benefit to shareholders? Would requiring the disclosure separately for each NEO affect this benefit?

57. How would the proposed treatment of equity awards, particularly the valuation and inclusion of such awards in executive compensation actually paid at the time at which they meet all vesting conditions, affect compliance costs and the comparability of the disclosure across registrants? Would the registrant's valuation of equity awards as of their vesting date provide new data of use to shareholders, relative to the compensation data currently required to be disclosed? What are the costs and benefits of alternative approaches to treating equity awards in the definition of executive compensation actually paid?

58. How would the proposed treatment of pension plans in executive compensation actually paid for registrants other than smaller reporting companies affect the costs and benefits of the proposed amendments, including any effects on compliance costs and the comparability of the disclosure across registrants? Would the inclusion in this compensation measure of only the actuarial present value of benefits attributable to services rendered during the applicable fiscal year provide new data of use to shareholders, relative to the pension information currently required to be disclosed? Would the adjustment provide a computation that makes information of interest to shareholders more readily available to them, even if this information is already disclosed in another form? What are the costs and benefits of alternative approaches to treating pension plans in the definition of executive compensation actually paid?

59. Would the proposed scaled disclosure requirements for smaller reporting companies reduce the compliance burden for such registrants while not adversely impacting shareholders? Could the disclosure be otherwise scaled for smaller reporting companies to minimize the incremental burden on smaller reporting companies while preserving the benefits to shareholders?

60. What effect would the proposed amendments have on the incentives of boards, senior executives, and shareholders? Would the proposed amendments be likely to change the behavior of these parties, registrants, shareholders, or other market participants? Should we alter the proposed requirements to address that impact? If so, describe any changes that would address that impact and discuss any related costs and benefits that would arise from such a change.

61. Is the proposal likely to lead to shareholder confusion, such as about the optimality of current pay-versus-performance alignment? Is the proposed ability to provide additional, alternative measures of compensation and performance, as well as the proposed flexibility in presentation format, sufficient to offset potential shareholder confusion? Would such additional measures or variation in formats meaningfully limit the comparability of the disclosure across registrants or otherwise affect the benefits of Exchange Act Section 14(i)? Is there additional information that we could require of all registrants, or particular minimum standards for the presentation format, that would enhance comparability and the benefits to shareholders at a reasonable cost to registrants?
62. What effect would the proposed amendments have on competition? Would the proposed amendments put registrants subject to the requirements or particular types of registrants subject to the requirements at a competitive disadvantage? If so, what changes to the proposed requirements could mitigate the impact while still satisfying the mandate of Exchange Act Section 14(i)?
63. What effect would the proposed amendments have on market efficiency? Are there any positive or negative effects of the proposed amendments on efficiency that we should consider? How could the amendments be changed to promote any positive effect or to mitigate any negative effect on efficiency, while still satisfying the mandate of Exchange Act Section 14(i)?
64. What effect would the proposed amendments have on capital formation? How could the amendments be changed to promote capital formation or to mitigate any

negative effect on capital formation resulting from the amendments, while still satisfying the mandate of Exchange Act Section 14(i)?

V. Paperwork Reduction Act

A. Background

Certain provisions of the proposed amendments contain a "collection of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[162] The Commission is submitting the proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[163] An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid control number. The titles for the collections of information are:

"Regulation S-K" (OMB Control No. 3235-0071);[164]

"Regulation 14A and Schedule 14A" (OMB Control No. 3235-0059); and

"Regulation 14C and Schedule 14C" (OMB Control No. 3235-0065).

We adopted all of the existing regulations and schedules pursuant to the Securities Act or the Exchange Act. The regulations and schedules set forth the disclosure requirements for registration statements and proxy and information statements filed by registrants to help shareholders make informed investment and voting decisions. Our

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162 44 U.S.C. 3501 et seq.

163 44 U.S.C. 3507(d) and 5 CFR 1320.11.

164 The paperwork burden from Regulation S-K is imposed through the forms that are subject to the requirements in those regulations and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens and for administrative convenience, we assign a one-hour burden to Regulation S-K.

proposed amendments to existing schedules and regulations are intended to satisfy the requirements of Section 14(i) of the Exchange Act.

The hours and costs associated with preparing, filing and sending the schedule constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. Compliance with the amendments is mandatory. Responses to the information collections will not be kept confidential and there is no mandatory retention period for the information disclosed.

B. Summary of Collection of Information Requirements

We are proposing to add new Item 402(v) to Regulation S-K. This item would require registrants to provide a table containing the values of the prescribed measures of executive compensation actually paid and the Summary Compensation Table measure of total compensation for the PEO and as an average for the other NEOs, as well as TSR both for the registrant and the peer group. The data in the table, including the footnote disclosure of the amounts deducted and added to the Summary Compensation Table measure, would be required to be tagged in XBRL. Proposed Item 402(v) also would require a registrant to provide a clear description of the relationship between executive compensation actually paid to its NEOs and the registrant's TSR for each of the five most recently completed fiscal years. A registrant also would be required to disclose the relationship between its TSR and peer group TSR. This disclosure about the relationship between a registrant's executive compensation actually paid and its TSR, and the disclosure about a registrant's TSR and peer group TSR would be required to be tagged in XBRL. Emerging growth companies and foreign private issuers would not be required to provide the disclosure. Smaller reporting companies would be subject to scaled disclosure requirements. The proposed disclosure would be required in proxy statements on Schedule 14A and information statements on Schedule 14C in which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required.

We have proposed to base much of the information required in the pay-versus-performance disclosure on items that are already required elsewhere in the executive compensation disclosure provided by registrants. We believe that using as a starting point the total compensation that registrants already are required to report in the Summary Compensation Table and making adjustments to those figures will help reduce the burden on registrants in preparing the disclosure required by new Item 402(v) of Regulation S-K. As discussed above, the proposed amendments are not expected to result in the provision of significant new information to shareholders, or to require registrants to collect significant new data, relative to current disclosure requirements. All of the individual components and assumptions needed to calculate executive compensation actually paid already must be reported under existing disclosure requirements, with the exception of vesting-date valuation assumptions for options.

We arrived at the estimates discussed below by reviewing our burden estimates for similar disclosure and considering our experience with other tagged data initiatives. We believe that the proposed amendments regarding pay-versus-performance disclosure would enhance the already required compensation disclosure. In addition, we believe that much of the information required to prepare the pay-versus-performance disclosure would be readily available to registrants because it is required to be gathered, determined or prepared in order to satisfy the other disclosure requirements of Item 402 of Regulation S-K.

We estimate that the average incremental burden for a registrant to prepare the pay-versus-performance disclosure would be 15 hours. This estimate includes the time and cost of preparing disclosure that has been appropriately reviewed, including, as applicable, by management, in-house counsel, outside counsel and members of the board of directors as well as tagging the data in XBRL format. Because this estimate is an average of all companies, the burden could be more or less for any particular company, and may vary depending on a variety of factors, such as the degree to which companies use the services of outside professionals, or internal staff and resources to tag the data in XBRL. This burden, as discussed in more detail below, would be added to the current burdens for Schedule 14A and Schedule 14C.

As a result of the estimates discussed above, we estimate for purposes of the PRA that the total incremental burden on all registrants of the proposed amendments would be 67,500 hours for internal company time and $9,000,000 for the services of outside professionals. For the proxy and information statements on Schedule 14A and Schedule 14C, we estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden of preparation is carried by outside professionals retained by the company at an average cost of $400 per hour. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours. There is no change to the estimated burden of Regulation S-K because the burdens that this regulation imposes are reflected in our revised estimates for the forms.

C. Paperwork Reduction Act Burden Estimates

We derived our new burden hour and cost estimates by estimating the total amount of time it would take a registrant to prepare and review the disclosure requirements contained in the final rules. This estimate represents the average burden for all registrants, both large and small. Because it is difficult to determine the precise number of emerging growth companies, we have not adjusted the estimates to back the number of these companies out of our estimate, even though emerging growth companies would not be subject to the proposed amendments. In deriving our estimates, we recognize that the burdens will likely vary among individual registrants based on a number of factors, including the size and complexity of their executive compensation arrangements. We believe that some registrants will experience costs in excess of this average in the first year of compliance with the amendments and some registrants may experience less than the average costs.

A summary of the proposed changes is included in the table below.

Table 1: Calculation of Incremental PRA Burden Estimates[165]

	Current Annual Responses (A)	Proposed Annual Responses (B)	Current Burden Hours (C)	Increase in Burden Hours (D)	Proposed Burden Hours (E) =C+D	Current Professional Costs (F)	Increase in Professional Costs (G)	Proposed Professional Costs =F+G
Schedule 14A	5,446	5,446	714,586	61,268	775,854	$85,664,277	$8,169,000	$93,833,277
Schedule 14C	554	554	66,784	6,232	73,016	$7,952,549	$831,000	$8,783,549
Total				67,500			$9,000,000	

165 The number of responses reflected in the table equals the three-year average of the number of schedules filed with the Commission and currently reported by the Commission to OMB.

D. Solicitation of Comments

We request comments in order to evaluate: (1) whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information would have practical utility; (2) the accuracy of our estimate of the burden of the proposed collection of information; (3) whether there are ways to enhance the quality, utility, and clarity of the information to be collected; (4) whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology; and (5) whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.[166]

Any member of the public may direct to us any comments about the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. _________. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. ________, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549-2736. OMB is required to make a decision

166 We request comment pursuant to 44 U.S.C. 3506(c)(2)(B).

concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. Initial Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act ("RFA")[167] requires the Commission, in promulgating rules under Section 553 of the Administrative Procedures Act,[168] to consider the impact of those rules on small entities. Section 603(a) of the RFA[169] generally requires the Commission to undertake a regulatory flexibility analysis of all proposed amendments to determine the impact of such rulemaking on "small entities."

A. Reasons For, and Objectives of, the Proposed Action

The proposed amendments are designed to implement Exchange Act Section 14(i), which was added by Section 953(a) of the Dodd-Frank Act and would exempt certain reporting companies. Specifically, the proposed amendments would require registrants, other than emerging growth companies and foreign private issuers, to disclose in any proxy or information statement for which disclosure under Item 402 of Regulation S-K is required, the relationship between executive compensation actually paid to the NEOs and the financial performance of the registrant for the three most recently completed fiscal years, taking into account any change in the value of the shares of stock and dividends of the registrant and any distributions.

B. Legal Basis

167 5 U.S.C. 601 *et seq.*

168 5 U.S.C. 553.

169 5 U.S.C. 603(a).

We are proposing the amendments pursuant to Section 953(a) of the Dodd-Frank Act and Sections 3(b), 14, 23(a) and 36 of the Exchange Act.

C. Small Entities Subject to the Proposed Amendments

The proposed amendments would affect some companies that are small entities. For purposes of the RFA, under our rules, an issuer, other than an investment company,[170] is a "small business" or "small organization" if it has total assets of $5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed $5 million.[171] We estimate that there are approximately 428 issuers that may be considered small entities. The proposed amendments would affect small entities that have a class of securities that are registered under Section 12 of the Exchange Act. An investment company, including a business development company, is considered to be a "small business" if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[172] We believe that the proposal would affect some small entities that are business development companies who have a class of securities registered under Section 12 of the Exchange Act. We estimate

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170 For purposes of the RFA, an investment company is a "small business" or "small organization" that, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year. [17 CFR 270.0-10].

171 *See* Securities Act Rule 157 [17 CFR 230.157]; Exchange Act Rule 0-10(a) [17 CFR 240.0-10(a)].

172 17 CFR 270.0-10(a).

that there are approximately five business development companies that may be considered small entities.[173]

D. Duplicative, Overlapping or Conflicting Federal Rules

As noted above, much of the information required by the proposed amendments is derived from information currently required to be reported under existing disclosure rules. Nevertheless, we believe that the repackaging of this information in the required pay-versus-performance disclosure may allow shareholders to more quickly and easily process the information accurately and thereby lower the burden on shareholders, including shareholders of smaller entities, of evaluating executive compensation packages. We do not believe that the proposed amendments would conflict with other federal rules.

E. Significant Alternatives

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;
- Use of performance rather than design standards; and

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173 We estimate that there are 13 business development companies that would be subject to the proposed amendment, five of which may be considered small entities for purposes of the RFA.

- Exempting small entities from all or part of the proposed amendments.

The proposed amendments would require clear disclosure of prescribed measures of executive compensation actually paid and the company's financial performance and the relationship between these measures. All of the individual components needed to calculate executive compensation actually paid already must be reported under current disclosure rules, with the exception of the values to be included with respect to pension benefits and options. Given the straightforward nature of the proposed disclosure, we do not believe that it is necessary to exempt small entities from the proposed requirements. However, we have proposed scaled disclosure requirements for smaller reporting companies in an attempt to limit the compliance burden that would be imposed on such companies.[174] Entities that are smaller reporting companies would be subject to the proposed amendments, but would provide only three years of disclosure, instead of the proposed five years for all other registrants. Also, the proposed amendments would require smaller reporting companies to disclose absolute TSR, but they would not be required to disclose peer group TSR. In addition, because the scaled compensation disclosure that applies to smaller reporting companies does not include pension plans, the pension plan adjustment would not apply to smaller reporting companies. To the extent that a small entity is a registrant, we believe that there are few, if any, small entities that

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174 A smaller reporting company is an issuer, other than certain classes of issuers (including an investment company), that had a public float of less than $75 million as of the end of its most recently completed second fiscal quarter, or in the case of an initial registration statement under the Securities Act or Exchange Act for the shares of its common equity, had a public float of less than $75 million as of a date within 30 days of the date of the filing of the registration statement. See Securities Act Rule 405 [17 CFR 230.405]. In the case of an issuer whose public float was zero, an issuer could qualify as a smaller reporting company if it had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available.

do not qualify as smaller reporting companies because it is unlikely that an entity with total assets of $5 million or less would have a public float of $75 million or more. A small entity, therefore, would likely be subject to the scaled disclosure requirements described above that are proposed for smaller reporting companies. We believe this will minimize any adverse impact on these companies of providing new disclosures which they do not currently provide.

With respect to compliance timetables, the proposed rules provide smaller reporting companies with transitional relief whereby such companies would be required to provide two years of data, instead of three, in the first proxy filing after the rules become effective, and three years of data in subsequent proxy filings. The proposed rules also provide smaller reporting companies with a phase-in of the requirement to provide the disclosure in XBRL format.

Although the proposed amendments would require disclosure of prescribed measures of executive compensation actually paid and financial performance, they would permit issuers significant flexibility in presenting the relationship between these measures. For example, issuers, including small entities, could describe the relationship in narrative form or by means of a graph or chart. In this respect, the proposed amendments make use of both design and performance standards as a means of balancing the need for uniform disclosure across registrants with the desire to provide registrants with flexibility to describe their pay-versus-performance relationship in a format that is best suited to their particular circumstances.

Commenters are asked to described the nature of any impact on small entities and provide empirical data to support the extent of the impact.

VII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[175] a rule is "major" if it has resulted, or is likely to result in:

- an annual effect on the U.S. economy of $100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposal would be a "major rule" for purposes of the Small Business Regulatory Enforcement Fairness Act. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries; and
- any potential effect on competition, investment, or innovation.

VIII. Statutory Authority and Text of Proposed Amendments

We are proposing the amendments contained in this document under the authority set forth in Section 953(a) of the Dodd-Frank Act and Sections 3(b), 14, 23(a) and 36 of the Exchange Act.

List of Subjects

17 CFR Parts 229, 240 and 249.

Reporting and Recordkeeping requirements; Securities.

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

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[175] Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

PART 229 -- STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 -- REGULATION S-K

1. The general authority citation for Part 229 continues to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78l, 78m, 78n, 78n-1, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*, and 18 U.S.C. 1350 unless otherwise noted.

*   *   *   *   *

2. Amend § 229.402 by:

Adding paragraph (v).

The addition reads as follows:

§ 229.402 Executive compensation.

*   *   *   *   *

(v) *Pay versus Performance*. (1) Provide the information specified in paragraph (v)(2) of this item for each of the registrant's last five completed fiscal years in the following tabular format:

PAY VERSUS PERFORMANCE

Year (a)	Summary Compensation Table Total for PEO (b)	Compensation Actually Paid to PEO (c)	Average Summary Compensation Table Total for non-PEO named	Average Compensation Actually Paid to non-PEO named executive officers (e)	Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)

			executive officers (d)			

(2) The Table shall include:

(i) The fiscal year covered (column (a));

(ii) The PEO's total compensation for the covered fiscal year as reported in the Summary Compensation Table pursuant to paragraph (c)(2)(x) of this Item, or paragraph (n)(2)(x) for smaller reporting companies (column (b)), and the average total compensation reported for the remaining named executive officers reported pursuant to those paragraphs (column (d));

(iii) The executive compensation actually paid to the PEO (column (c)) and the average executive compensation actually paid to the remaining named executive officers (column (e)). If more than one person served as the registrant's PEO during a fiscal year, include in column (c) the aggregate compensation actually paid for the persons who served as PEO. For purposes of columns (c) and (e) of the table required by paragraph (v)(1) of this Item, executive compensation actually paid shall be the total compensation for the covered fiscal year for each named executive officer as provided in paragraph (c)(2)(x) of this Item, or paragraph (n)(2)(x) for smaller reporting companies, adjusted to:

(A) Deduct the aggregate change in the actuarial present value of the named executive officer's accumulated benefit under all defined benefit and actuarial pension plans reported in the Summary Compensation Table in paragraph (c)(2)(viii)(A) of this Item;

(B) Add the service cost under all defined benefit and actuarial pension plans reported in the Summary Compensation Table in paragraph (c)(2)(viii)(A) calculated as the actuarial present value of each named executive officer's benefit under all such plans attributable to services rendered during the covered fiscal year, consistent with "service cost" as defined in FASB ASC Topic 715; and

(C) Deduct the amounts reported in the Summary Compensation Table pursuant to paragraphs (c)(2)(v) and (c)(2)(vi) of this Item and add in their place the fair value on the vesting date of all stock awards, and all options awards, with or without tandem SARs (including awards that subsequently have been transferred), for which all applicable vesting conditions were satisfied during the covered fiscal year.

(iv) For purposes of columns (f) and (g) of the table required by paragraph (v)(1) of this Item, for each year disclose the cumulative total shareholder return of the registrant (column (f)) and peer group cumulative total shareholder return (column (g)) calculated in the same manner, and over the same measurement period, as under Item 201(e) of Regulation S-K. The term "measurement period" shall be the period beginning at the "measurement point" established by the market close on the last trading day before the registrant's earliest fiscal year in the table, through and including the end of the registrant's last completed fiscal year. The closing price of the measurement point must be converted into a fixed investment, stated in dollars, in the registrant's stock (or in the stocks represented by the peer group). For each fiscal year, the amount included in the table shall be the cumulative total shareholder return as of the end of that year. The same methodology must be used in calculating both the registrant's total shareholder return and that of the peer group.

(3) For each amount disclosed in columns (c) and (e) of the table required by paragraph (v)(1), disclose in a footnote to the table for the PEO and the average remaining named executive officer compensation each of the amounts deducted and added pursuant to paragraph (v)(2)(iii). For disclosure of the executive compensation actually paid to named executive officers other than the PEO, provide the amounts required under this paragraph as averages.

(4) For the value of equity awards added pursuant to paragraph (v)(2)(iii)(C), disclose in a footnote to the table required by paragraph (v)(1) any assumption made in the valuation that differs materially from those disclosed pursuant to Instruction 1 to Item 402(c)(2)(v) and (vi), or for smaller reporting companies, Instruction 1 to Item 402(n)(2)(v) and (vi).

(5) In proxy or information statements in which disclosure is required pursuant to this Item, use the information provided in the table required by paragraph (v)(1) to provide a clear description of the relationship between (i) the executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) listed in the Summary Compensation Table, and (ii) the cumulative total shareholder return of the registrant (column (f)), for each of the registrant's last five completed fiscal years. This description shall also include a comparison of the cumulative total shareholder return of the registrant (column (f)) and cumulative total shareholder return of the registrant's peer group (column (g)) over the same period.

(6) The disclosure required to be provided pursuant to this paragraph (v) shall appear with, and in the same format as, the rest of the disclosure required to be provided

pursuant to paragraph (v) and, in addition, shall be electronically formatted using the eXtensible Business Reporting Language (XBRL) in accordance with the EDGAR Filer Manual (17 CFR 232.11) as an exhibit to definitive Schedule 14A (17 CFR 240.14a-101) or definitive Schedule 14C (17 CFR 240.14c-101). Each amount required to be disclosed in the table pursuant to paragraph (v)(1) must be tagged separately. The disclosure required to be provided pursuant to paragraphs (v)(3), (v)(4) and (v)(5) of this Item must be block-text tagged.

Instructions to Item 402(v).

1. *Transitional relief.* A registrant may provide the disclosure required by paragraph (v) for three years, instead of five years, in the first filing in which it provides this disclosure, and provide disclosure for an additional year in each of the two subsequent annual filings in which this disclosure is required.

2. *Repricings and other modifications.* If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise price of previously vested options or SARs held by a named executive officer, whether through amendment, cancellation or replacement grants, or any other means, or otherwise has materially modified such awards, the registrant shall include in the compensation reported under paragraph (v)(2)(iii)(C) of this Item the incremental fair value, computed as the excess fair value of the modified award over the fair value of the original award upon vesting of the modified award. If the modified award is subject to multiple vesting dates, the registrant shall include in the compensation reported under paragraph (v)(2)(iii)(C) the pro rata incremental fair value paid at each vesting date.

3. *Fair value.* Fair value amounts shall be computed in a manner consistent with the fair value measurement guidance in FASB ASC Topic 718.

4. *Presentation.* If more than one person served as the PEO of the registrant during the covered fiscal year, then the compensation for all persons who served as the PEO of the registrant for that year shall be aggregated.

5. *Exempted registrants.* A registrant is not required to comply with paragraph (v) of this Item if it is an emerging growth company, as defined in Section 3(a) of the Exchange Act (15 U.S.C. 78c(a)).

6. *New registrants.* Information for fiscal years prior to the last completed fiscal year will not be required if the registrant was not required to report pursuant to section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) at any time during that year.

7. *Peer group.* For purposes of determining the total shareholder return of the registrant's peer group, the registrant shall use the same index or issuers used for purposes of Item 201(e)(1)(ii) or, if applicable, the companies it uses as a peer group for purposes of Item 402(b). If the peer group is not a published industry or line-of-business index, the identity of the issuers comprising the group must be disclosed. The returns of each component issuer of the group must be weighted according to the respective issuers' stock market capitalization at the beginning of each period for which a return is indicated.

8. *Smaller reporting companies.* A registrant that qualifies as a "smaller reporting company," as defined by §229.10(f)(1), may provide the information required by paragraph (v) for three years, instead of five years. A smaller reporting company may provide the disclosure required by paragraph (v) for only two fiscal years in the first

filing in which it provides this disclosure, and is not required to provide the disclosure required by paragraph (v)(5) with respect to the total shareholder return of its peer group. For purposes of paragraph (v)(2)(iii) of this Item with respect to smaller reporting companies, executive compensation actually paid shall be the total compensation for the covered fiscal year for each named executive officer as provided in paragraph (n)(2)(x) of this Item, adjusted to deduct the amounts reported in the Summary Compensation Table pursuant to paragraphs (n)(2)(v) and (n)(2)(vi) of this Item, and to add in their place the fair value on the vesting date of the amounts added in paragraph (v)(2)(iii)(C). Disclose in a footnote to the table required pursuant to paragraph (v)(1) for the PEO and average remaining named executive officer compensation the amounts deducted from, and added to, the Summary Compensation Table pursuant to this instruction. A smaller reporting company is required to comply with paragraph (v)(6) in the third filing in which it provides the disclosure required by paragraph (v).

9. *Incorporation by reference*. The information in paragraph (v) of this Item will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

* * * * *

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

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

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 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, and 7210 et seq.; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5521(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376, (2010), unless otherwise noted.

* * * * *

4. Amend § 240.14a-101 by adding Item 25.

The addition reads as follows:

§240.14a-101 Schedule 14A. Information required in proxy statement.

SCHEDULE 14A INFORMATION

* * * * *

Item 25. Exhibits.

Provide the information required to be disclosed by Item 402(v)(1) of Regulation S-K (17 CFR 229.402(v)(1)) in an exhibit to this Schedule 14A electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard.

* * * * *

By the Commission.

Brent J. Fields

Secretary

April 29, 2015

Commissioner Gallagher
Commissioner Piwowar
Dissented as to
Municipal Advisors and
NRSRO Bars

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9762 / April 29, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74836 / April 29, 2015

Admin. Proc. File No. 3-15211

In the Matter of

FRANCIS V. LORENZO
c/o Robert G. Heim
Meyers & Heim LLP
444 Madison Ave., 30th Floor
New York, NY 10022

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Antifraud Violations

A formerly registered representative committed securities fraud by sending two potential investors emails that he knew contained false and misleading information about his firm's client. *Held*, it is in the public interest to bar respondent from associating with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in an offering of penny stock; order him to cease and desist from committing or causing any violations or future violations of the provisions violated; and order him to pay a civil monetary penalty of $15,000.

APPEARANCES:

Robert G. Heim, for Francis V. Lorenzo.

Alex Janghorbani and *Jack Kaufman*, for the Division of Enforcement.

Appeal filed: January 27, 2014
Last brief received: May 7, 2014
Oral argument: March 30, 3015

I.

Francis V. Lorenzo, formerly a registered representative, appeals an administrative law judge's finding that he violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5 by sending false and misleading statements to prospective investors.[1] For these violations, the law judge barred Lorenzo from the securities industry, ordered him to cease and desist from violating the antifraud provisions, and ordered him to pay a third-tier civil monetary penalty of $15,000. The Division cross-appeals the imposition of the civil penalty and asks that we increase the penalty to "at least $100,000."

The charges against Lorenzo stem from emails he sent to retail customers that contained false and misleading statements about a debenture offering by his client, Waste2Energy Holdings, Inc. ("W2E"). The emails promised the customers that their investment would have three "layers of protection": (i) that W2E had more than $10 million "in confirmed assets"; (ii) that W2E had "purchase orders and [letters of intent] for over $43 mm in orders"; and (iii) that Lorenzo's employer, Charles Vista, LLC, had "agreed to raise additional monies to repay these Debenture holders (if necessary)." Lorenzo admitted at the hearing that he knew each of these statements was false and/or misleading when he sent them. For the reasons below, his conduct violated the antifraud provisions of the federal securities laws and warrants imposition of an industry-wide bar, a cease-and-desist order, and a $15,000 civil penalty. Our findings are based on an independent review of the record.[2]

II.

Lorenzo was director of investment banking at Charles Vista, LLC, a registered broker-dealer owned by Gregg Lorenzo,[3] from February 2009 through February 2010 (the relevant time

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1 *Francis V. Lorenzo*, Initial Decision Release No. 544, 2013 WL 6858820 (Dec. 31, 2013).

2 We note that Rule of Practice 451(d), 17 C.F.R. § 201.451(d), permits a member of the Commission who was not present at oral argument to participate in the decision of the proceeding if that member has reviewed the oral argument transcript before such participation. Commissioner Aguilar has made the requisite review.

3 Gregg Lorenzo is not related to the respondent. We will refer to the respondent as "Lorenzo" and to Gregg Lorenzo as "Gregg Lorenzo."

here). As Lorenzo described it, Charles Vista was "a small boiler room." Its registered representatives, Lorenzo explained, engaged in high-pressure sales tactics, were "not being a hundred percent accurate in their presentations" to brokerage clients, and seemed to be "stretching the truth."[4] Lorenzo's only investment banking client during the relevant time was W2E. Lorenzo's responsibilities included preparing offering documents for W2E; making sure the company made all material disclosures; and conducting due diligence, including reviewing the company's financial statements and public filings.

A. Lorenzo knew that W2E was in dire financial condition.

According to W2E's Form 8-K (filed June 3, 2009), the company developed technology for customers "to convert[] biomass or other solid waste streams traditionally destined for landfill or incineration into clean renewable energy." But according to Lorenzo, W2E's technology "didn't really work" and the company's "financial well-being was horrible." As the company explained in its Form 8-K, W2E had been "operating at a substantial operating loss each year since [its] inception," had "a substantial accumulated deficit," and expected "to continue to incur substantial losses for the foreseeable future." The company's unaudited financial statements, which were included in the Form 8-K, disclosed that the company had total assets (as of December 31, 2008) of approximately $14 million and total liabilities of approximately $9.5 million. Of its approximately $14 million in total assets, W2E attributed more than $10 million to "intangibles," which consisted of intellectual property. The company's Form 8-K further disclosed that W2E's business operations depended on generating substantial revenues from one customer, Ascot Environmental Ltd., which subjected W2E to "significant financial and other risks in the operation of [its] business." The company also disclosed that its independent registered auditors had "expressed substantial doubt about [its] ability to continue as a going concern."

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[4] Charles Vista and Gregg Lorenzo settled related charges against them in November 2013. *Gregg C. Lorenzo*, Securities Act Release No. 9480, 2013 WL 6087352 (Nov. 20, 2013) (Settlement Order). Before that settlement, on June 17, 2013, Charles Vista had already withdrawn its registration as a broker-dealer, and FINRA cancelled Charles Vista's membership on July 31, 2013, for failure to pay outstanding fees. We take official notice of this information on BrokerCheck, an electronic database maintained by FINRA and available at http://brokercheck.finra.org. *See* 17 C.F.R. § 201.323 (rule of practice relating to official notice). On June 18, 2013, FINRA also permanently barred Gregg Lorenzo from association with any member for his refusal to comply with multiple requests to appear for an on-the-record interview. *See* http://brokercheck.finra.org (last visited April 28, 2015).

Lorenzo testified that he saw the company's Form 8-K shortly after the company issued it and was concerned at the time that W2E's purported intangible assets were not actually worth $10 million. He instead believed that the intangibles were a "dead asset." There was "no way," Lorenzo testified, that the company could "get even close to $10 million" for the assets, and the company would be "lucky" to receive $1 million for the assets. Lorenzo also thought it was significant that W2E's financial statements were unaudited because "there is way too much risk for investors" without an audit.

B. Lorenzo helped prepare the private placement memorandum for W2E's convertible debentures offering.

By mid-August 2009, W2E was finalizing an audit of its financial statements for the fiscal year ending March 31, 2009, so that those statements could be included in its Form 10-Q. Around the same time, the company also began preparing a private placement of up to $15,000,000 in 12 percent convertible debentures.[5] Charles Vista was the exclusive placement agent for the debenture offering, for which the firm was to be paid nearly 20 percent of the offering proceeds—an amount Lorenzo described as "exorbitant." Lorenzo testified that he was promised seven to nine percent of any money he raised from the offering, but that he ultimately received only one percent of the money he raised.

Lorenzo helped W2E prepare the private placement memorandum ("PPM"). At least twice during that process, Lorenzo asked W2E to disclose the $10 million of intangible assets in its PPM because he thought it was "material." On August 26, 2009, Lorenzo emailed edits and comments regarding the PPM to the company, writing that, "[w]e want to mention that the company has IP and Intangibles valued at $10,038,558" (emphasis in original). Lorenzo testified that he based that number on the unaudited financial statements in W2E's Form 8-K. On September 1, 2009, Lorenzo emailed additional edits to W2E, again asking that they include a reference to the company's intangible assets. But this time Lorenzo left the value of the assets blank because, he testified, he was no longer sure what the assets were worth. Lorenzo also admitted that, as early as April 2009, he began repeatedly telling Gregg Lorenzo not to sell W2E's debentures as being collateralized by the $10 million asset. Lorenzo explained that he did so because he knew that the assets "provided no protection" to investors and that, if the company defaulted on the debentures, investors would not be able to recoup their money through the liquidation of those assets.

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[5] Debentures are "debt secured only by the debtor's earning power, not by a lien on any specific asset." BLACK'S LAW DICTIONARY 330 (9th ed. 2009), *available at* Westlaw Blacks.

Lorenzo did not recall that anyone from W2E ever responded to his requests to disclose the intangible assets, and ultimately W2E did not disclose a dollar value for its intangible assets in its final PPM, which was dated September 9, 2009. Instead, W2E disclosed only that it had "a significant IP portfolio." The company also reiterated many of the disclosures from its earlier Form 8-K, including that the company "had significant operating losses," did "not expect to be profitable for at least the foreseeable future," and could not "predict when we might become profitable, if ever." The company further stated in the PPM that it was "wholly reliant on the net proceeds from this Offering to fund [its] proposed business" and that, "[i]f less than the Maximum Offering [$15 million] is sold, [it] will have an immediate need for substantial additional capital and may only have enough capital for less than one month of proposed operations." The company added: "If we are unable to raise substantial capital, investors will lose their entire investment." Lorenzo testified that he received and reviewed the final PPM.

C. W2E announced a complete write down of its intangible assets.

On October 1, 2009, approximately one month after finalizing the PPM, W2E filed an amended Form 8-K and Form 10-Q. Those filings contained audited financial statements for the fiscal year ended March 31, 2009, and reported a complete write-off of W2E's $10 million intellectual property asset and $496,594 in good will. The company stated that, as of March 31, 2009, its total assets were only $370,552 and that its sole contract (with Ascot Environmental) was causing it to incur a net loss.

Lorenzo testified that, although it was his responsibility to review W2E's filings, he only "skimmed the filings and [he] missed the write off." Lorenzo nevertheless acknowledged that, on October 5, four days after the company filed its financial statements disclosing the write down, W2E's CFO sent Lorenzo an email, stating: "The accumulated deficit we have reported is due to three primary issues [including] . . . . [w]rite off of all of our <u>intangible</u> assets . . . of about $11 million." (emphasis in original). Lorenzo admitted that he reviewed the email and therefore understood, by at least October 5, 2005, that the company had written off the $10 million in intangible assets.

D. Lorenzo emailed two prospective investors about W2E's debenture offering, falsely assuring them of three "layers of protection."

On October 14, 2009, Lorenzo sent a one-page email to two retail customers—Vishal Goolcharan and William Rothe—entitled "W2E Debenture Deal Points." The emails stated that, "[a]t the request of Adam Spero and Gregg Lorenzo, the Investment Banking division of Charles

Vista has summarized several key points of the Waste2Energy Holdings, Inc. Debenture Offering."[6] The emails then told the investors, in bold type, "Please read the Offering Memorandum, including all the 'Risk Factors,'" but Lorenzo acknowledged that he did not know whether either customer ever actually saw the PPM because he never sent them one.

Lorenzo's emails next summarized the offering's basics, including the debenture's term and the interest rate, and promised that investors would be paid first in the event of liquidation. The emails then assured investors:

> There are 3 layers of protection:
>
> (I) The Company has over $10 mm in confirmed assets
> (II) The Company has purchase orders and LOI's [sic] for over $43 mm in orders
> (III) Charles Vista has agreed to raise additional monies to repay these Debenture holders (if necessary).

After noting the debenture holders' right to convert their debt into common stock and to receive a warrant to purchase shares, the emails concluded, "Please call with any questions—Truly, Francis V. Lorenzo."

Lorenzo admitted that, at the time he sent the emails, he knew that the statements about all three layers of supposed protection were false, misleading, or both. Lorenzo acknowledged, for example, that the statement about the company having $10 million in confirmed assets "was never true." Lorenzo testified that he took the $10 million number from the company's unaudited financial statements in its June 2009 Form 8-K, which stated that the company had $10 million in intangible assets. Yet Lorenzo admitted that this number had never been confirmed by auditors or the company; that he knew by the time he sent the emails that the company had written off those assets; and that he himself did not believe the company's intangible assets had been worth anywhere close to $10 million. Lorenzo also admitted that, before sending the emails, he knew that the $43 million in purported purchase orders and LOIs were based only on a single, non-binding, letter of intent, which did not obligate the potential purchaser (or W2E) to do anything. He further acknowledged that, by sometime in September, he had "lost confidence that this 43 million was ever going to happen." Lorenzo similarly admitted that he knew, at the

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6 This quote is from the email to Goolcharan. The email to Rothe did not mention Adam Spero, stating only that Gregg Lorenzo had asked the investment banking division to summarize the debenture offering.

time he sent the emails, that Charles Vista had not agreed to raise any additional money to repay debenture investors.

Lorenzo explained his sending the emails as a "mistake." Lorenzo testified that he sent the emails without thinking about the contents: "I don't want to minimize the severity of it but, you know, I just didn't give it much thought at the time. My boss asked me to send these e-mails out and I sent them out." On December 18, 2009, one of the email recipients, Vishal Goolcharan, invested $15,000 in W2E's debenture offering (jointly with Roslyn Parmasad). Lorenzo earned one percent (or $150) from that investment.

E. Lorenzo provided misleading investigative testimony about Gregg Lorenzo, Charles Vista, and W2E's debenture offering.

The Division subsequently launched an investigation into Lorenzo and his employer, Charles Vista and Gregg Lorenzo, during which Lorenzo testified under oath in November 2009. Lorenzo told Commission staff that Gregg Lorenzo was an "honest guy"; that he was proud of what Gregg Lorenzo planned at Charles Vista; and that he and Gregg Lorenzo were working toward their "vision" of building Charles Vista into a "high quality investment banking [d]ivision." Lorenzo further testified that he "believed in" selling W2E's debentures and described the sale as one of several "high quality projects."

Lorenzo's subsequent hearing testimony was far different. As noted above, for instance, Lorenzo described Charles Vista as a boiler room and expressed concern that the firm's registered representatives were not entirely truthful when selling securities. Lorenzo also testified that, by November 2009, "there [was] no way on God's green earth [he] thought Gregg Lorenzo was an honest guy"; that, by October 2009, it was "a stretch" to say that he was proud of the work he and Gregg Lorenzo were doing at Charles Vista; and that he did not think that Charles Vista was a high-quality investment bank. Nor did Lorenzo describe W2E's debenture offering as a high-quality project, instead labeling it a "toxic convertible debt spiral."

Lorenzo testified that he began looking for a new job sometime in October or November 2009 because he had become "unhappy" at Charles Vista. He eventually left Charles Vista in February 2010 and became a managing director at Hunter Wise Securities, LLC, a broker-dealer where Lorenzo focused primarily on arranging funding for both public and private companies. Lorenzo represents that he resigned from this position on April 15, 2014. He is not currently registered.[7]

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[7] *See* http://brokercheck.finra.org (last visited April 28, 2015).

III.

The Division alleges that Lorenzo violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, and Securities Act Section 17(a) by sending two materially misleading emails to customers. Section 10(b) makes it "unlawful for any person directly or indirectly . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" Commission rules.[8] Rule 10b-5 implements the Commission's authority under Section 10(b).[9] It does so through three subsections that are "mutually supporting rather than mutually exclusive."[10] The first, Rule 10b-5(a), prohibits "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud."[11] The second, Rule 10b-5(b), prohibits "directly or indirectly . . . mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made . . . not misleading."[12] The third, Rule 10b-5(c), prohibits "directly or indirectly . . . engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."[13]

Section 17(a), in turn, makes it unlawful to engage in certain conduct in "the offer or sale of securities."[14] Like Rule 10b-5, Section 17(a) expresses its prohibitions in three "mutually supporting" subsections.[15] Relevant here is Section 17(a)(1), which, like Rule 10b-5(a), prohibits "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud."[16] Liability under Section 17(a) and Rule 10b-5 requires a showing of scienter, which is "a mental state

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8 15 U.S.C. § 78j(b).

9 *See John P. Flannery*, Securities Exchange Act Release No. 73840, 2014 WL 7145625, at *10 (Dec. 15, 2014) (citing *United States v. Zandford*, 535 U.S. 813, 816 n.1 (2002)), *appeal docketed*, No. 15-1080 (1st Cir. Jan. 16, 2015).

10 *Id.* (citing *Cady, Roberts & Co.*, Exchange Act Release No. 6668, 40 SEC 907, 1961 WL 60638, at *4 (Nov. 8, 1961)).

11 17 C.F.R. § 240.10b-5(a).

12 *Id.* § 240.10b-5(b).

13 *Id.* § 240.10b-5(c).

14 15 U.S.C. § 77q(a). We find, and there is no dispute, that all of the statements and omissions at issue here were made in connection with the offer or sale of securities.

15 *Cady, Roberts & Co.*, 1961 WL 60638, at *4.

16 15 U.S.C. § 77q(a)(1).

embracing intent to deceive, manipulate, or defraud."[17] As explained below, we agree with the Division that Lorenzo violated these provisions by knowingly sending materially misleading emails to prospective investors.

A. The emails that Lorenzo sent were misleading.

We first examine whether the emails Lorenzo sent were misleading. There is no dispute that the statement regarding the first layer of protection—that the company had "over $10 mm in confirmed assets"—was misleading. In fact, Lorenzo admitted that this statement had never been true. Lorenzo derived that number from the $10 million in intangible assets listed in the company's unaudited financial statements. But by the time Lorenzo wrote the emails, W2E had written off those assets and disclosed that it had only $400,000 in assets remaining. And Lorenzo himself testified that he did not believe at the time he sent the emails that the company's intangible assets were worth anywhere close to $10 million. Lorenzo's emails to customers stating otherwise were therefore plainly false and would mislead any reader about the state of the company's assets.

The statement regarding the second layer of supposed protection—that the company had "purchase orders and LOI's for over $43 mm in orders"—was also misleading. As Lorenzo testified, this assurance was based on a single, non-binding, letter of intent, which did not obligate the potential purchaser (or W2E) to do anything. Lorenzo argues on appeal that W2E's CEO "believed in the validity of this LOI [and] that it would turn into customer orders." But that assertion is based on Lorenzo's own, self-serving testimony about what W2E's CEO may have believed. And even if that *is* what the CEO believed, it is still only vague speculation that the LOI *could* "turn into customer orders." Lorenzo's written statements promising the prospective investors that the company *had* over $43 million in orders was therefore false and would mislead any reader about the company's future revenue.

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[17] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter may be established through "a heightened showing of recklessness." *Flannery*, 2014 WL 7145625, at *10 n.24. This has been "defined as . . . an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it." *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *5 (Dec. 21, 2007); *accord SEC v. Ficken*, 546 F.3d 45, 47–48 (1st Cir. 2008) (finding that Section 17(a)(1), Section 10(b), and Rule 10b–5 require only "a high degree of recklessness" (quotations omitted)); *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1093 (D.C. Cir. 2005) (finding that Rule 10b-5 requires a showing of extreme recklessness).

The third statement—that Charles Vista had agreed to raise additional money—was also misleading. As Lorenzo admitted, Charles Vista had no such agreement with W2E. Lorenzo nevertheless argues on appeal that the emails' assurance to the contrary was "not an unreasonable statement because Gregg Lorenzo had on a number of prior occasions raised money to pay back debenture holders" and because Gregg Lorenzo had been meeting with other broker-dealers about raising additional funds for W2E. But even if these claims were true, they establish only the theoretical possibility that Charles Vista could have raised additional money to repay investors, not that it had agreed to do so (as Lorenzo's emails claimed). Lorenzo also admitted that, even if Charles Vista *had* agreed to raise additional money, it would have had a difficult time doing so: Charles Vista, Lorenzo explained, did not have "the buying power or resources to properly fund Waste2Energy in order to repay the debentures." Lorenzo's assurance that Charles Vista had agreed to raise additional money was therefore false and would mislead any investor about the prospects of Charles Vista actually raising additional money in the event of W2E's default.

B. The misrepresentations in the emails were material.

We next examine whether the misrepresentations were material. For a misstatement to be material, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[18] It does not matter whether "disclosure of the omitted fact would have caused the reasonable investor to change" his behavior.[19]

That standard is met here. Lorenzo's emails concerned an unsecured debt offering by a company in dire financial straits. Yet instead of mentioning any of the substantial risks involved, Lorenzo falsely assured retail customers that their investment would be protected in three different ways.[20] A reasonable investor would have found the accuracy of any one of these

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18 *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

19 *TSC Indus.*, 426 U.S. at 449.

20 We note that, while the emails directed the customers to read the PPM (which disclosed some of the risks involved with the offering but not the company's $10 million write-down), Lorenzo never sent them the disclosure document and did not know whether they ever saw it. *Cf. New Jersey Carpenters Health Fund v. Royal Bank of Scotland*, 709 F.3d 109, 127 (2d Cir. 2013) (explaining that "'[t]here are serious limitations on a corporation's ability to charge its stockholders with knowledge of information omitted from a document such as a . . . prospectus on the basis that the information is public knowledge and otherwise available to them'"); *SEC v.*

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promises of protection to significantly alter "the 'total mix' of information made available" given the company's precarious financial state and the offering's unsecured nature.[21] That all three statements were inaccurate—meaning that any investment had essentially no protection—made the misrepresentations all the more material to prospective investors.

C. Lorenzo acted with scienter when sending the materially misleading emails to customers.

We next turn to the question of scienter—namely, whether Lorenzo knew or must have known that his emails were materially misleading.[22] That standard is met here. Regarding the first layer of supposed protection (that the company had "over $10 mm in confirmed assets"), Lorenzo admitted knowing that W2E had written off its $10 million in intangible assets when he sent the emails. Lorenzo also acknowledged that, even before the write-off, he had considered the supposed $10 million in intangibles to be "dead assets" because there was "no way" that W2E could "get even close to $10 million" for them. Lorenzo further admitted that, for more than half a year before sending the emails, he repeatedly told Gregg Lorenzo not to sell the debentures as being collateralized by the intangible assets because he understood that those assets would not protect the customers' investment.

Lorenzo's testimony similarly establishes that he knew or must have known that the statement regarding the second layer of supposed protection (the alleged $43 million in purchase orders and LOIs) was both false and misleading. Lorenzo admitted that, before sending the emails, he knew that the $43 million in purported purchase orders and LOIs were based on only a single, non-binding letter of intent, which did not obligate the potential purchaser (or W2E) to do anything and that, by sometime in September, Lorenzo had "lost confidence that this 43 million

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Morgan Keegan & Co., Inc., 678 F.3d 1233, 1252 (11th Cir. 2012) (rejecting defendant's motion for summary judgment on the "materiality" issue by noting that the "misstatements must be considered in the factual context of a weak, or non-existent, distribution of the written disclosures"). And while W2E previously disclosed the $10 million write-down and lack of other assets in its Forms 8-K and 10-Q, that information was more than six months old when Lorenzo sent the emails. A reasonable investor could therefore believe, as Lorenzo's emails implied, that the company's fortunes had changed in that time—a misimpression furthered by Lorenzo's other false claims about the company's supposedly strong revenue stream of $43 million in purchase orders and letters of intent and Charles Vista's supposed willingness to raise additional funds.

21 *TSC Indus.*, 426 U.S. at 449.

22 *See supra* note 17 (defining scienter).

was ever going to happen." He even acknowledged that, while he could not say with "a hundred percent" certainty that the statement was misleading, "I could see it being misleading."

And regarding Lorenzo's third misstatement (Charles Vista's supposed agreement to raise additional money), Lorenzo admitted that, at the time of the emails, he knew that Charles Vista had not agreed to raise any additional money to repay debenture investors. He further acknowledged that, even if such an agreement had existed, he knew, "long before October," that W2E would have had a difficult time raising additional money because Charles Vista had already invested 70 percent of all of its brokerage clients' money in W2E, an amount Lorenzo acknowledged was "way too much." Because of this, Lorenzo admitted, "Charles Vista would not have the buying power or resources to properly fund Waste2Energy in order to repay the debentures." In fact, when asked at the hearing whether his assurance that Charles Vista would raise additional money was misleading, he admitted that "you couldn't hang your hat on it."

Despite this evidence of scienter, Lorenzo asserts on appeal that he had a good faith belief in the truthfulness of his emails and that there is no basis for concluding that he "acted with intent to deceive investors." He claims it was "entirely reasonable" to state that the company had $10 million in confirmed assets because that figure was taken from the company's unaudited financial statements, which had been filed with the Commission. Lorenzo further reasons that it was not reckless for him to have missed the company's subsequent write off because W2E allegedly "buried" that fact in its filings and failed to fulfil a contractual agreement that Lorenzo claimed the company had with Charles Vista to immediately disclose any material changes in W2E's financial condition. The write down "needed to be emphasized," Lorenzo testified, "not minimized and not hidden in a regulatory document. There [are] no disclosures anywhere, anywhere that this asset may have been written off to 95 percent. None. Zero."

These contentions are both implausible and contradicted by Lorenzo's testimony. W2E was Lorenzo's only investment banking client, and it was his job to review the company's financial statements. Lorenzo knew at the time he received the filings that W2E was in dire financial condition. He had also believed for months that the company's assets were not worth "even close to $10 million." That Lorenzo could have looked at the company's filings, which was his job, and missed what was one of the most pertinent facts in them—the valuation of the company's assets—is either untrue or extreme recklessness.[23] But even if Lorenzo did initially

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[23] Lorenzo points to Charles Vista's chief compliance officer's sending an email to Charles Vista's brokers (which contained a research report showing that W2E's assets exceeded $10 million) as evidence that the compliance officer also missed the asset write down in W2E's

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miss W2E's write-down, Lorenzo admitted that he learned about it a few days later, when the company's CFO emailed him about it. In fact, when asked during his investigative testimony about whether he knew at the time he sent the emails that the statements about the three layers of protection were inaccurate and misleading, he answered, "I can't sit here and say that I didn't know."

Lorenzo also admitted during the hearing that he did not believe that W2E was a worthwhile investment; that he had "lost confidence in the management of Waste2Energy to grow the business"; and that he thought it was "highly unlikely . . . that [W2E] was going to have enough corporate growth in order to pay back the money that it had borrowed." These worries about the company's offering, combined with his long-standing concern about the legitimacy of the company's $10 million in claimed assets, establish that it was at least extremely reckless for Lorenzo to email customers that their investment would be protected by $10 million in confirmed assets without first checking that statement against the company's most recent financial statements.[24]

We also disagree with Lorenzo's claim that his forwarding the company's public filings (which contained the $10 million write down) to Charles Vista's brokers shortly after receiving them shows that he lacked the intent to misrepresent or hide W2E's financial condition. Forwarding the company's filings internally to Charles Vista employees does not explain or excuse Lorenzo's subsequent decision to send materially misleading emails externally to firm customers. And the record contains evidence of at least one possible motive for misleading potential investors: Lorenzo knew when he sent the emails that his employer, Charles Vista, would earn what he described as an "exorbitant" fee from any successful sales and that he would

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financial statements and thus represented "some evidence that Mr. Lorenzo was not acting recklessly or negligently when he missed it." But there was no testimony or other evidence introduced about the circumstances surrounding the distribution of that document, and the mere fact that, for whatever unknown reason, a compliance officer sent an inaccurate research report internally to the firm's brokers is neither analogous to, nor an excuse for, Lorenzo's knowingly sending materially misleading emails to prospective investors.

[24] *Cf. Rita J. McConville*, Exchange Act Release No. 51950, 2005 WL 1560276, at *9 n.36 (June 30, 2005) (finding violations of Section 10(b) and Rule 10b-5 because "it was at least reckless [for respondent to] not actually review the [Form 10-K] about which she was making representations"), *pet. for review denied*, 465 F.3d 780 (7th Cir. 2006).

receive a portion of those fees.[25] Lorenzo's testimony clearly establishes that he either knew or must have known that his emails would materially mislead investors.[26]

Nor are we persuaded by Lorenzo's assertion that his sending the emails was simply a "mistake." Lorenzo was well aware that the emails falsely represented crucial facts about W2E and its debenture offering. Sending emails to customers was also not a normal occurrence for Lorenzo. In fact, he contends that these emails were the only time he ever communicated with customers. His claim that he nevertheless "didn't give [sending the emails] much thought" is therefore implausible. And if Lorenzo did send the emails without "think[ing] about it one way or the other," as he claims, such a dismissive attitude toward investors' interests would be equally troubling and still constitute acting with extreme recklessness.

D. Lorenzo "made" the material misstatements in the emails.

Lorenzo argues that even if he knowingly sent the materially misleading emails to customers, he cannot be a primary violator of the antifraud provisions because he did not "make" the misstatements at issue. In support, Lorenzo cites the Supreme Court's decision in *Janus Capital Group v. First Derivative Traders*, which interpreted Rule 10b-5(b)'s prohibition against "mak[ing] any untrue statement of a material fact" as extending only to those with "ultimate authority" over an alleged false statement.[27] This argument is doubly flawed.

As a preliminary matter, because the language that a primary violator must "make" a misstatement appears in only Rule 10b-5(b), the Division need not establish that a defendant

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25 *Cf. Donald L. Koch*, Exchange Act Release No. 72179, 2014 WL 1998524, at *14 (May 16, 2014) ("[P]roof of motive is not required where there is direct evidence of manipulative intent; it is only where direct evidence of scienter is lacking that circumstantial evidence of intent, such as motive, becomes critical.").

26 Lorenzo argues that the Division failed to introduce any expert testimony that would establish the proper standard of care for investment bankers conducting placements of debentures or that would establish that Lorenzo acted recklessly in not catching W2E's write down of its assets. But we need not rely on expert testimony when determining such legal questions. *Cf. Dearlove v. SEC*, 573 F.3d 801, 804 (D.C. Cir. 2009) (stating that "the SEC need not have received expert testimony to establish the standard of care or to determine whether Dearlove's conduct was unreasonable"); *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *17 (May 27, 2011) (stating that the Commission is not hindered by the lack of expert testimony when determining whether a securities violation has occurred).

27 131 S. Ct. 2296, 2302–05 (2011).

"made" a misstatement to establish liability under the other antifraud provisions.[28] And as to Rule 10b-5(b), we conclude that Lorenzo "made" each misstatement by exercising "ultimate authority over the statement, including its content and whether and how to communicate it."[29] Although Lorenzo's emails stated that he was summarizing several key points of the debenture offering at Gregg Lorenzo's "request," Lorenzo testified during his investigatory testimony that he did not recall ever discussing either of the emails or their subject matter with Gregg Lorenzo. Lorenzo later testified at the hearing that he "got the e-mail addresses from [Gregg Lorenzo]," but that, "[i]f memory serves me—I think I authored [the email] and then it was approved by Gregg and Mike [Molinario, Charles' Vista's compliance officer]." Lorenzo also put his own name and direct phone number at the end of the emails, and he sent the emails from his own account.[30] Lorenzo further testified that he understood that Gregg Lorenzo wanted the emails to come from the investment banking division (which Lorenzo oversaw) and that, by sending the emails, Lorenzo was putting his own reputation on the line.[31]

On appeal, Lorenzo disputes that he was a "maker" of the emails by asserting that he "merely helped to distribute the statements by sending the email that Gregg Lorenzo drafted." Yet there is no persuasive evidence of that. At best, Lorenzo provided conflicting and ambiguous testimony about his and Gregg Lorenzo's respective roles in the emails. For example, when asked during the hearing whether he knew it was misleading to tell customers that W2E had $10 million in confirmed assets, Lorenzo testified that he "just made a mistake and sent it. I cut and pasted and sent it. I made a mistake." Lorenzo later testified that, "as soon as [Gregg Lorenzo] gave me the e-mail address, I typed it into the 'to' column and cut and pasted this – the content

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28 *See Flannery*, 2014 WL 7145625, at *10–19.

29 *Janus*, 131 S. Ct. at 2302.

30 *Cf. City of Roseville Employees Ret. Sys. v. Energysolutions, Inc.*, 814 F. Supp. 2d 395, 417 (S.D.N.Y. 2011) (stating that there was "no dispute" that each of the defendants who had signed the misstatements had "made" the statements under *Janus*); *S.W. Hatfield, CPA*, Exchange Act Release No. 73763, 2014 WL 6850921, at *6 (Dec. 5, 2014) (finding that respondents had "made" the misstatements where they "drafted, dated, printed on Firm letterhead, and signed" the documents containing the misstatements).

31 *Cf. Janus*, 131 S. Ct. at 2302 (stating that "attribution within a statement or implicit from surrounding circumstances is strong evidence" that the statement "was made by" the party to whom it was attributed); *SEC v. Greystone Holdings, Inc.*, No. 10-Civ-1302, 2012 WL 1038570, at *9 (S.D.N.Y. Mar. 28, 2012) (finding that chief operating officer was the "maker" of misstatements in certain press releases under *Janus* despite defendant's claim that the chief executive officer had ultimate authority over issuance of press releases).

and sent it out." Lorenzo also claimed, "My boss asked me to send these e-mails out and I sent them out." But all that this self-serving testimony establishes is that Gregg Lorenzo may have asked Lorenzo to email certain customers about the debenture offering and that he provided Lorenzo with the email addresses to do so. It does not establish that anyone other than Lorenzo was ultimately responsible for the emails' content. Nor do the emails themselves establish this. They state only that Gregg Lorenzo had requested that Lorenzo's investment banking division summarize the debenture offering, not that Gregg Lorenzo wrote or had anything else to do with the substance of that summary. To the contrary, Lorenzo testified at the hearing that he remembered authoring the emails himself. And during his earlier investigative testimony, Lorenzo testified that he did not recall ever discussing the emails or their subject matter with Gregg Lorenzo. We therefore find that Lorenzo was ultimately responsible for the emails' content and dissemination and was thus the maker of the misstatements within the meaning of Rule 10b-5(b).[32]

E. Lorenzo's role in the misrepresentation constituted a deceptive "device," an "artifice to defraud," and a deceptive "act" in violation of Section 10(b), Rule 10b-5(a) and (c), and Section 17(a)(1).

We also find that Lorenzo employed a "device, scheme, or artifice to defraud," in violation of Section 17(a)(1) and Rule 10b-5(a); that he engaged in an "act" that would operate as a fraud in violation of Rule 10b-5(c); and that his conduct was deceptive, as required by Section 10(b). Independently of whether Lorenzo's involvement in the emails amounted to "making" the misstatements for purposes of Rule 10b-5(b), he knowingly sent materially misleading language from his own email account to prospective investors. Lorenzo's role in producing and sending the emails constituted employing a deceptive "device," "act," or "artifice to defraud" for purposes of liability under Section 10(b), Rule 10b-5(a) and (c), and Section 17(a)(1).[33]

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32 Although the law judge found that "Gregg Lorenzo had drafted [the emails] relating to the debenture offering to two Charles Vista clients," she did so after weighing the evidence, rather than after making a credibility determination. And even if she had made a credibility finding, we do not accept such findings "blindly." *Ofirfan Mohammed Amanat*, Exchange Act Release No. 54708, 2006 WL 3199181, at *8 n.46 (Nov. 3, 2006) (noting that "'there are circumstances where, in the exercise of our review function, we must disregard explicit determinations of credibility'" (quoting *Kenneth R. Ward*, Securities Act Release No. 8210, (Mar. 19, 2003) *aff'd*, 75 F. App'x 320 (5th Cir. 2003))), *pet. denied*, 269 F. App'x 217 (3d Cir. 2008); *see also supra* note 35 and accompanying text (describing our *de novo* review).

33 *See Flannery*, 2014 WL 7145625, at *12–13 (concluding that Rule 10b-5(a) and (c) and

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F. The Commissions' *de novo* review cures any alleged errors in the initial decision.

In his appeal, Lorenzo challenges the sufficiency of the law judge's findings, arguing that the law judge "simply plugged in the facts from Lorenzo's case into [an] earlier [initial decision, *Gualario & Co., LLC*],[34] when they just don't fit." Among other things, Lorenzo contends that the law judge failed to specify which of the three statements at issue in the present case were false, why they were false, or the basis for finding that Lorenzo acted with scienter. Lorenzo similarly claims that the law judge reached her sanctions determinations by "essentially cut[ting] and pasting the facts of Lorenzo's case into the earlier decision," when, according to Lorenzo, "the acts committed [in *Gualario*] were much more severe and completely dissimilar to the facts in this case." Lorenzo contends that, because the law judge did not make adequate findings, "there is no way the Commission can perform an adequate review of its findings." We disagree. Any alleged deficiencies in the law judge's analysis are of no consequence because our review is *de novo*; the violations we find and the sanctions we impose are based on our own independent review of the record.[35] In particular, we find that notwithstanding differences between the facts in this case and those in *Gualario*, the record evidence of Lorenzo's own, unique misconduct and the risks he poses to investors establishes both the violations we find and the propriety of the sanctions we impose for all the reasons described herein.

IV.

The law judge imposed the following sanctions against Lorenzo: (i) a bar from associating with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization companies and from participating in an offering of penny stock; (ii) an order to cease and desist from committing or causing any violations or future violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5; and (iii) and a third-tier civil penalty

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Section 17(a)(1) encompass drafting or devising, in addition to "making," a fraudulent misstatement); *accord SEC v. Clark*, 915 F.2d 439, 448 (9th Cir. 1990) (noting that Rule 10b-5(a) and (c) "provide a broad linguistic frame within which a large number of practices may fit").

[34] Initial Decision Release No. 452, 2012 WL 627198 (Feb. 14, 2012).

[35] *See* Rule of Practice 411(a), 17 C.F.R. § 201.411(a) ("The Commission may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record.").

of $15,000. We find that these sanctions are appropriate and necessary to protect the investing public.

A. Barring Lorenzo from the industry is appropriate.

Exchange Act Section 15(b)(6) authorizes the Commission to bar a respondent from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, nationally recognized statistical rating organization, and from participating in an offering of penny stock "if that person has willfully violated any provision of the Exchange Act . . . and the bar is in the public interest."[36] We find that these elements are met and that an industry-wide bar is appropriate.

1. Lorenzo willfully violated the securities laws.

We first find that Lorenzo's conduct was willful. It is well established that "[a] willful violation under the federal securities laws simply means 'that the person charged with the duty knows what he is doing.'"[37] It is sufficient that the actor "intentionally" or "voluntarily" committed the act that constitutes the violation; he need not also be aware that he is violating one of the securities laws or rules promulgated thereunder.[38] Lorenzo claims that he did not give "much thought" to sending the emails, but there is no dispute that Lorenzo intentionally sent them.

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

We assess whether a bar is in the public interest by considering the egregiousness of Lorenzo's conduct, the isolated or recurrent nature of the infraction, the degree of scienter involved, Lorenzo's recognition of the wrongful nature of his conduct, the sincerity of any assurances against future violations, and the likelihood that Lorenzo's occupation will present

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[36] 15 U.S.C. § 78o(b).

[37] *Johnny Clifton*, Exchange Act Release No. 69982, 2013 WL 3487076, at *11 n.75 (July 12, 2013) (quoting *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)).

[38] *Wonsover*, 205 F.3d at 414; *accord Mathis v. SEC*, 671 F.3d 210, 217 (2d Cir. 2012) (stating that willfulness "means intentionally committing the act which constitutes the violation [and that there] is no requirement that the actor also be aware that he is violating one of the Rules or Acts"); *Jason A. Craig*, Exchange Act Release No. 59137, 2008 WL 5328784, at *4 (Dec. 22, 2008) (stating that a willful violations of the securities laws requires that we "need to find only that [the respondent] voluntarily committed the acts that constituted the violation, not that [the respondent] was aware of the rule he violated or that he acted with a culpable state of mind").

opportunities for future violations.[39] Our inquiry into these factors "is a flexible one, and no one factor is dispositive."[40] Here, these considerations weigh in favor of barring Lorenzo from the industry.

Lorenzo's conduct was egregious. A fundamental purpose of the securities laws is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry."[41] Because of this, "[t]he proper functioning of the securities industry and markets depends on the integrity of industry participants and their commitment to transparent disclosure."[42] Lorenzo demonstrated a complete disregard for these principles by grossly misleading, if not outright lying to, retail customers about the significant risks involved in purchasing W2E's debentures. We have repeatedly warned that such violations of the antifraud provisions are "'especially serious and subject to the severest of sanctions under the securities laws.'"[43]

Lorenzo has also displayed troubling dishonesty. He sent his two misleading emails separately, to different customers, thus presenting separate opportunities to mislead prospective investors. And while Lorenzo seeks credit for voluntarily testifying to Commission staff during its investigation, his testimony painted a notably misleading picture of his employer and W2E's offering. For example, while Lorenzo initially described Gregg Lorenzo to Commission staff as an "honest guy," he later admitted at the hearing that "there [wa]s no way on God's green earth I thought Gregg Lorenzo was an honest guy." Lorenzo similarly described W2E's debt offering as a high quality project during the investigation but later admitted that he thought the offering was "a toxic convertible debt spiral."

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39 *Ronald S. Bloomfield*, Exchange Act Release No. 71632, 2014 WL 768828, at *18 (Feb. 27, 2014); *accord Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

40 *Disraeli*, 2007 WL 4481515, at *15 (quoting *Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 WL 2790633, at *4 (Sept. 26, 2007), *pet. for review denied*, 548 F.3d 129 (D.C. Cir. 2008)), *pet. for review denied*, 334 F. App'x 334 (D.C. Cir. 2009).

41 *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963).

42 *Clifton*, 2013 WL 3487076, at *14 (quoting *John W. Lawton*, Advisers Act Release No. 3513, 2012 WL 6208750, at *11 (Dec. 13, 2012)).

43 *Peter Siris*, Exchange Act Release No. 71068, 2013 WL 6528874, at *6 (Dec. 12, 2013) (quoting *Vladimir Boris Bugarski*, Exchange Act Release No. 66842, 2012 WL 1377357, at *4 (Apr. 20, 2012)), *pet. for review denied*, 773 F.3d 89 (D.C. Cir. 2014).

Lorenzo also acted with a high degree of scienter. Lorenzo knew, when he sent his emails to customers, that he was misstating critical facts about W2E and the safety of its debenture offering.[44] That Lorenzo so blatantly ignored the importance of communicating truthfully with potential investors creates a significant risk that he will engage in similar misconduct in the future and demonstrates his unfitness to participate in the securities industry.[45]

Lorenzo's unwillingness to accept responsibility for this misconduct further weighs in favor of a bar. Although he claims to have "apologized many times for his limited involvement with the W2E debentures" and to "regret[] the emails being sent out," he continues to blame W2E and Gregg Lorenzo for his actions. Lorenzo claims, for instance, that W2E failed to inform him properly of the $10 million write-down and that he sent the emails at Gregg Lorenzo's direction. But none of these supposed failures by others explains, or excuses, Lorenzo's decision to send retail customers emails that he knew contained materially misleading statements. Such a refusal to accept responsibility "has long been deemed an appropriate measure of fitness for association in the industry."[46]

We are particularly troubled by Lorenzo's continued attempts to shift blame onto W2E for not disclosing the company's write down more fully. Lorenzo criticized W2E's supposed lack of disclosure by testifying that the company's $10 million write-down "deserved a Sermon on the Mount meeting" and "needed to be emphasized, emphasized, not minimized and not hidden in a regulatory document." Yet when discussing his own failure to disclose the same write-down to

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44 *Cf. Jeffrey L. Gibson*, Exchange Act Release No. 57266, 2008 WL 294717, at *3 (Feb. 4, 2008) (stating that respondent's conduct "evince[d] a high degree of scienter" because "he knew [the private placement memorandum]'s representations with respect to the use of proceeds were misleading"), *pet. for review denied*, 561 F.3d 548 (6th Cir. 2009).

45 *Cf. Tzemach David Netzer Korem*, Exchange Act Release No. 70044, 2013 WL 3864511, at *7 (July 26, 2013) (finding that "the deliberate manner in which Korem flouted [a core] responsibility suggests that he is likely to engage in future misconduct"); *Lawton*, 2012 WL 6208750, at *9 (considering past conduct as evidence in a "broader inquiry into whether a person presents a future risk to the public interest because, as the Supreme Court has recognized, the 'degree of intentional wrongdoing evident in a defendant's past conduct' is an important indication of the defendant's propensity to subject the trading public to future harm" (quoting *Aaron v. SEC*, 446 U.S. 680, 701 (1980))).

46 *Gregory Bartko*, Exchange Act Release No. 71666, 2014 WL 896758, at *11 (Mar. 7, 2014) (finding that respondent's unwillingness to accept responsibility weighed in favor of a bar); *accord Seghers*, 548 F.3d at 137 (holding that imposition of a more severe sanction for refusal to accept responsibility "did not unconstitutionally burden [respondent] in the district court . . . nor did it deny him due process before the SEC").

investors, Lorenzo dismissed his conduct as an "unintentional miscue" and his involvement as "limited." Although a respondent has the right to present a vigorous defense, we find that Lorenzo's continued attempts here to shift blame and minimize his role in deceiving investors demonstrate that he "does not fully understand the seriousness of his misconduct and how it violated the duties of a securities professional" and "presents a significant risk that, given th[e] opportunity, he would commit further misconduct in the future."[47]

Nor does the lack of any demonstrated causal link between Lorenzo's emails and the customers' ultimate investment decisions weigh against a bar. The Division is not required to establish either reliance or loss by any investor.[48] Instead, "our focus is on the welfare of investors generally and the threat one poses to investors and the markets in the future."[49] And that is particularly true here, as Lorenzo's emails created a substantial risk to investors by misleading them about the likelihood of losing much, if not all, of any investment.

We are also unpersuaded by Lorenzo's claim that his occupation will not present opportunities for future violations. Lorenzo contends that his communicating with retail customers "was a unique occurrence that was outside the scope of his investment banking responsibilities—both at Charles Vista and at his [subsequent] firm," but his admission that sending emails to customers was not within his normal duties heightens our concern that Lorenzo will engage in future misconduct if allowed to remain in the industry, no matter the scope of that employment. As we have repeatedly observed, "[t]he securities industry presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence."[50] And the antifraud provisions that Lorenzo violated apply to all securities industry participants. While we recognize the severity of a collateral bar and its obvious impact on Lorenzo's ability to continue working in the securities industry, we find, for all the reasons discussed herein, that imposing such a bar on Lorenzo from associating with any

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47 *Clifton*, 2013 WL 3487076, at *14 (citations omitted).

48 *See, e.g.*, *Morgan Keegan & Co.*, 678 F.3d at 1244; *Graham v. SEC*, 222 F.3d 994, 1001 n.15 (D.C. Cir. 2000).

49 *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at *9 (Feb. 13, 2009) (citing *Christopher A. Lowry*, 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)); *cf. Korem*, 2013 WL 3864511, at *5 (rejecting respondent's argument that his conduct was not egregious because there was no harm or loss).

50 *Seghers*, 2007 WL 2790633, at *7; *see also Koch*, 2014 WL 1998524, at *21 n.224 (citing cases).

investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in an offering of penny stocks is necessary to prevent Lorenzo from putting investors at further risk and will deter other market professionals from engaging in similar misconduct.[51]

Lorenzo argues that imposing such a bar is so "grossly disproportionate to the offense at issue, particularly given Mr. Lorenzo's long unblemished career in the securities industry," that it violates the Eighth Amendment's prohibition against excessive punishment. We disagree. Although some mitigating factors exist, including that Lorenzo has a relatively clean disciplinary record, that he claims to have made some effort at assisting defrauded investors, and that he earned relatively little profit from his misconduct, his claims of mitigation are far outweighed by the gravity of his violations and the risk of his committing future violations.[52] Our intent in ordering that Lorenzo be barred from the industry is to protect the investing public from further harm, not to punish Lorenzo.[53] And the Exchange Act specifically authorizes us to impose such

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[51] *Cf. Lawton*, 2012 WL 6208750, at *12–13 (finding that a collateral bar was justified when respondent "reveal[ed] an attitude toward regulatory oversight that is fundamentally incompatible with the principles of investor protection"; violated professional responsibilities that are "not limited to a particular aspect of the securities industry"; and demonstrated "his ongoing unfitness and risk that he would engage in further misconduct if given future opportunities in the industry," where "opportunities for similar misconduct arise in each of the associational capacities covered by the collateral bar").

[52] *Cf. Philip J. Milligan*, Exchange Act Release No. 61790, 2010 WL 1143088, at *5 (Mar. 26, 2010) (imposing an associational bar despite a previously clean record); *Terrance Yoshikawa*, Exchange Act Release No. 53731, 2006 WL 1113518, at *8 (Apr. 26, 2006) (sustaining self-regulatory organization's imposition of a bar because, while the petitioner earned "a relatively small amount of profits," the potential harm to the markets "could be considerably greater than this dollar amount"); *Marshall E. Melton*, Exchange Act Release No. 48228, 56 SEC 695, 2003 WL 21729839, at *7 (July 25, 2003) (finding that respondent's previously clean record did not outweigh his misconduct and imposing a bar). We also note that Lorenzo's disciplinary history is not quite unblemished, as Lorenzo claims. In June 2011, FINRA suspended Lorenzo for twelve days in all capacities for failing to timely pay outstanding FINRA hearing session fees. *See* http://brokercheck.finra.org (last visited April 28, 2015).

[53] *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005); *cf. Seghers*, 2007 WL 2790633, at *9 (stating that imposition of a bar was "not intended to punish, but 'to protect the public interest from future harm at his hands'" (quoting *Leo Glassman*, Exchange Act Release No. 11929, 46 SEC 209, 1975 WL 160418, at *2 (Dec. 16, 1975))), *pet. for review denied*, 548 F.3d 129 (D.C. Cir. 2008).

an industry-wide bar.[54] Barring him from the industry is therefore not a punishment within the meaning of the Eighth Amendment.[55]

At oral argument, Lorenzo's counsel asserted that imposing an industry-wide bar would be inconsistent with the one-year suspension that we imposed against respondents in *John P. Flannery*.[56] But the Commission has consistently held that the "appropriate sanction depends upon the facts and circumstances of each particular case and cannot be determined precisely by comparison with actions taken in other proceedings."[57] And here, although Lorenzo and the respondents in *Flannery* all had relatively clean disciplinary histories, we find that the egregiousness of Lorenzo's misstatements, the high degree of his scienter, and his continued attempts to shift blame onto others, along with the other considerations discussed above, are distinguishable from *Flannery* and warrant a bar in this case. This conclusion is consistent with our repeated holding "that conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions under the securities laws."[58]

B. Ordering Lorenzo to cease and desist from violating the antifraud provisions is in the public interest.

Securities Act Section 8A(a) and Exchange Act Section 21C(a) authorize us to issue a cease-and-desist order against any person who "has violated" those statutes or rules thereunder.[59] When determining whether such an order is appropriate, we consider public interest factors that are substantially the same as those we consider when assessing whether to impose a bar.[60] "In

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[54] *Cf. Eric J. Brown*, Exchange Act Release No. 66469, 2012 WL 625874, at *18 (Feb. 27, 2012) (observing that substantial deference is granted to the legislature when determining whether a penalty is excessive under the Eighth Amendment).

[55] *Cf. Charles Phillip Elliot*, Exchange Act Release No. 31202, 50 SEC 1273, 1992 WL 258850, at *4 (Sept. 17, 1992) (finding that a bar from the industry is not a punishment within the meaning of the Eighth Amendment (citing *Flemming v. Nestor*, 363 U.S. 603, 613–14 (1960))).

[56] 2014 WL 7145625, at *10.

[57] *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 WL 5328765, at *17 n.68 (Dec. 19, 2008) (quoting *Christopher J. Benz*, Exchange Act Release No. 38440, 52 SEC 1280, 1997 WL 137027, at *4 (March 26, 1997), *petition denied*, 168 F.3d 478 (3d Cir. 1988) (Table)).

[58] *Siris*, 2013 SEC LEXIS 3924, at *23 (imposing a full collateral bar); *see also Clifton*, 2013 WL 3487076, at *14 (same).

[59] 15 U.S.C. § 77h-1(a) (Securities Act); *id.* § 78u-3(a) (Exchange Act).

[60] *See Joseph J. Barbato*, Exchange Act Release No. 41034, 53 SEC 1259, 1999 WL 58922, at

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addition, we consider whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought."[61] This inquiry is flexible, and no single factor is dispositive.[62] "Absent evidence to the contrary, a finding of violation raises a sufficient risk of future violation."[63]

As discussed above, Lorenzo's conduct was egregious, demonstrated a pattern of dishonesty, evidenced a high degree of scienter, and presents a substantial risk of future violations.[64] Lorenzo's clear failure to appreciate his responsibilities as a securities professional outweighs the various factors Lorenzo asserts as mitigating: that his misconduct occurred approximately five years ago; that he claims to "regret[] the emails being sent out"; that, after leaving Charles Vista, he claims to have spent "a substantial amount of time and effort assisting investors who purchased W2E debentures in organizing and filing claims"; and that he claims to have given "statements to the Commission, without retaining a lawyer, for the purpose of aiding the Commission, and particularly those who purchased W2E debentures."[65]

(...continued)

*14 n.31 (Feb. 10, 1999). For instance, we consider the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind in committing the violation, the sincerity of assurances against future violations, the respondent's recognition of the wrongful nature of the conduct, and the respondent's opportunity to commit future violations. *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 54 SEC 1135, 2001 WL 47245, at *26 (Jan. 19, 2001), *pet. for review denied*, 289 F.3d 109 (D.C. Cir. 2002).

61 *KPMG Peat Marwick*, 2001 WL 47245, at *26.

62 *Id.*

63 *Id.* at *24 (finding that a cease-and-desist order may be imposed only where there is some risk of future violations, but that the risk "need not be very great"); *see also Schoemann v. SEC*, 398 F. App'x 603, 604 (D.C. Cir. 2010) (per curiam) (affirming the imposition of a cease-and-desist order because petitioner's conduct "constituted a violation of the [Securities] Act"), *aff'g* Securities Act Release No. 9076, 2009 WL 3413043, at *12–13 (Oct. 23, 2009) (noting that "absent evidence to the contrary, a single past violation ordinarily suffices to raise a sufficient risk of future violations").

64 *See supra* notes 42–51 and accompanying text; *cf. Gregory O. Trautman*, Exchange Act Release No. 61167A, 2009 WL 6761741, at *21 (Dec. 15, 2009) (imposing cease-and-desist order for violations that "involved a high degree of scienter").

65 Lorenzo testified that, after he left Charles Vista, "a lot of clients, they didn't want to speak to Gregg [Lorenzo] anymore, so he would toss them to me." At which point, Lorenzo explained, "I got to know a few of these debentures holders, about 15." He said that he told them: "'My

(continued...)

Moreover, although we are ordering that Lorenzo be barred from serving in the securities industry, he could still rejoin the industry in a non-registered capacity or otherwise become active in the financial markets. Our concern that Lorenzo will commit future violations, regardless of any constraints placed on his involvement in the industry, is heightened by Lorenzo's acknowledgement that he sent the emails outside the scope of his investment banking responsibilities. Ordering Lorenzo to cease and desist from violating the antifraud provisions will serve the remedial purpose of encouraging Lorenzo to take his responsibilities more seriously should he be allowed to re-enter the securities industry or should he resume acting in a capacity that does not require registration.[66]

C. Imposing a civil penalty of $15,000 is in the public interest.

Securities Act Section 8A(g) and Exchange Act Section 21B(a) authorize us to impose civil monetary penalties for violations of those securities statutes if it is in the public interest and if, in the case of Exchange Act § 21B(a), the respondent willfully violated the Exchange Act.[67] As discussed above, Lorenzo acted willfully when committing his violations. The question is therefore whether a civil penalty is in the public interest, which we assess based on (i) whether the act or omission involved fraud or deliberate or reckless disregard of a regulatory requirement; (ii) whether the act or omission resulted in harm to others; (iii) the extent to which any person was unjustly enriched, taking into account restitution made to injured persons; (iv) whether the individual has committed previous violations; (v) the need to deter such person and others from committing violations; and (vi) such other matters as justice may require.[68]

We find that these factors weigh in favor of imposing a monetary sanction. We acknowledge Lorenzo's relative lack of disciplinary history, that the amount of his gain was relatively small ($150), and that there was no evidence that his conduct directly led to significant

(...continued)

suggestion is this, you form a group and you try and get some relief as a group from either Waste2Energy or Charles Vista.' I did this—I didn't charge him money to help. I just made the introduction."

66 *Cf. Trautman*, 2009 WL 6761741, at *21 (finding a cease-and-desist order to be appropriate where the Commission also imposed a bar).

67 15 U.S.C. §§ 77h-1 (providing that the Commission may impose civil penalties if it finds a violation of the Securities Act in a cease-and-desist proceeding), 78u-2 (providing that the Commission may impose civil penalties for any violation of the federal securities laws).

68 *Id.* § 78u-2(c).

customer losses. But none of this outweighs that Lorenzo displayed a knowing and reckless disregard for his obligations as a securities professional by sending materially misleading emails to retail customers. The need to deter Lorenzo from committing such deliberately fraudulent conduct in the future warrants imposition of a monetary sanction.

As for the amount of that sanction, the securities laws authorize us to impose first-tier penalties of up to $6,500 for each "act or omission"; second-tier penalties of up to $65,000 for each act or omission that "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement"; and third-tier penalties of up to $130,000 for each act or omission that "resulted in substantial losses," created "a significant risk of substantial losses to other persons," or resulted in "substantial pecuniary gain to the person who committed the act or omission."[69]

Here, we find that Lorenzo committed two "acts or omissions" in violation of the securities laws by sending two different customers a materially misleading email.[70] While the emails he sent were largely the same and sent close in time, they were not identical and provided Lorenzo two separate opportunities to mislead customers. As for the appropriate sanction for each act or omission, we find that a third-tier penalty is appropriate because Lorenzo's violations involved "fraud, deceit, [and] deliberate or reckless disregard of a regulatory requirement," while also creating "a significant risk of substantial losses" to the customers.[71] Specifically, Lorenzo hid the fact that W2E was in dire financial straits and that the customers were unlikely to recoup much, if any, of their investment in the event of default. This deceit created a significant risk that recipients of the emails would lose all of whatever they decided to invest. That the customers were ultimately unable, or unwilling, to invest more than $15,000 does not negate the possibility that Lorenzo's misleading emails could have resulted in far larger investments (and subsequent losses). After all, Lorenzo was seeking to raise $15,000,000 for W2E. Such a risk of substantial loss warrants imposition of the highest tier penalty, regardless of whether either customer actually read or relied on Lorenzo's emails when making their investment decision.[72]

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[69] *Id.* §§ 77h-1(g)(2), 78u-2(b); *see also* 17 C.F.R. § 201.1003 (setting forth the maximum penalty amounts for violations occurring from February 15, 2005 to March 3, 2009).

[70] *Cf. SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 288 n.7 (2d Cir. 2013) (finding no error in a district court counting each late trade as a separate violation).

[71] 15 U.S.C. §§ 77h-1(g)(2), 78u-2(b).

[72] *Cf. Clifton*, 2013 WL 3487076, at *16 (imposing a maximum third tier penalty where the

(continued...)

We nevertheless recognize Lorenzo's relative lack of profit, the lack of evidence that the emails harmed others, and Lorenzo's relatively clean disciplinary record. While we do not believe these mitigating factors outweigh the need to protect investors from future harm by barring him from the industry, we nevertheless decline to grant the Division's request to impose a $100,000 civil penalty. We instead find that a third-tier penalty of $7,500 for each of Lorenzo's emails (for an aggregate of $15,000) is in the public interest to deter Lorenzo and others in similar positions from committing future violations.

An appropriate order will issue.[73]

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN; Commissioners GALLAGHER and PIWOWAR concurring in part and dissenting with respect to the bars from association with municipal advisors and nationally recognized statistical rating organizations).

Brent J. Fields
Secretary

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

(...continued)

respondent had sought to raise more than $1 million, but where the record contained no evidence regarding actual losses nor substantial pecuniary gains).

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9762 / April 29, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74836 / April 29, 2015

Admin. Proc. File No. 3-15211

In the Matter of FRANCIS V. LORENZO c/o Robert G. Heim Meyers & Heim LLP 444 Madison Ave., 30th Floor New York, NY 10022

ORDER SUSTAINING DISCIPLINARY ACTION

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

ORDERED that Francis V. Lorenzo be barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in an offering of penny stocks; and it is further

ORDERED that Francis V. Lorenzo cease and desist from committing or causing any violations or future violations of Section 17(a)(1) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; and it is further

ORDERED that Francis V. Lorenzo pay a civil money penalty in the amount of $15,000.

Payment of the civil money penalty shall be: (i) made by U.S. postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial Management, Securities and Exchange Commission, 100 F. Street NE, Mail Stop 6042, Washington, DC 20549; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding. A copy of the cover letter and check shall be sent to Alex

Janghorbani and Jack Kaufman, Division of Enforcement, U.S. Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY, 10281.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74848 / April 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16522

In the Matter of Eden Energy Corp. and Fifth Season International, Inc. Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS[1]

1. Eden Energy Corp. ("EDNE") (CIK No. 1083866) is a revoked Nevada corporation located in Vancouver, British Columbia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EDNE 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, 2012, which reported a loss from continuing operations of $162,245 for the prior six months. As of April 27, 2015, the common stock of EDNE was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Fifth Season International, Inc. ("DYER") (CIK No. 1417907) is a void Delaware corporation located in Fuitan District, Shenzen, China with a class of securities registered with

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

the Commission pursuant to Exchange Act Section 12(g). DYER is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss from continuing operations of $16,596,748 for the prior nine months. As of April 27, 2015, the common stock of DYER was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74846 / April 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16521

In the Matter of **Cedar Creek Mines Ltd.,** **General Kinetics Incorporated,** **ProDigital Film Studios, Inc.** **(a/k/a ProDigital Film Labs, Inc.),** **Pyrocap International Corporation,** **SendTec, Inc., and** **Specialized Services, Inc.** **(n/k/a Exergetic 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. Cedar Creek Mines Ltd. ("CEDA") (CIK No. 1445196) is a Delaware corporation located in Burnaby, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CEDA 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, 2011, which reported a net loss of $87,639 for the prior nine months. As of April 27, 2015, the common stock of CEDA was quoted on OTC Link operated by OTC

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

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

2. General Kinetics Incorporated ("GKIN") (CIK No. 40675) is a purged Virginia corporation located in Johnstown, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GKIN is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2005, which reported a net loss of $267,800 for the prior six months. On February 9, 2007, GKIN filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Pennsylvania, which was closed on December 29, 2008. As of April 27, 2015, the common stock of GKIN 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. ProDigital Film Studios, Inc. (a/k/a ProDigital Film Labs, Inc.) ("PRGT") (CIK No. 1126318) is a permanently revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PRGT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended June 30, 2005, which reported a net loss of $145,012 for the prior year. As of April 27, 2015, the common stock of PRGT 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. Pyrocap International Corporation ("PYOC") (CIK No. 861631) is a purged Virginia corporation located in Woodbridge, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PYOC is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 1996, which reported a net loss of $537,904 for the prior nine months. As of April 27, 2015, the common stock of PYOC was traded on the over-the-counter markets.

5. SendTec, Inc. ("SNDN") (CIK No. 1296001) is a forfeited Delaware corporation located in St. Petersburg, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SNDN is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008. On June 15, 2009, SNDN filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Middle District of Florida, which was still pending as of January 7, 2015. As of April 27, 2015, the common stock of SNDN 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. Specialized Services, Inc. (n/k/a Exergetic Energy, Inc.) ("XNGR") (CIK No. 1123846) is a dissolved Michigan corporation located in Detroit, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). XNGR 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 $583,421 for the prior nine months. As of April 27, 2015, the common stock of XNGR was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74852 / April 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16523

In the Matter of **HUGO URREA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Hugo Urrea ("Urrea" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent, 57 years old, is a resident of Metairie, Louisiana. He is currently being supervised by the probation and parole department of East Jefferson, Louisiana. At the time of the relevant conduct, Respondent was engaged in activities as an unregistered broker-dealer.

B. RESPONDENT'S CRIMINAL CONVICTION

2. On September 17, 2012, Urrea pleaded guilty to eighteen felony counts in the 22d Judicial District Court, St. Tammany Parish, Louisiana, including unlawful securities practices, theft, theft of assets of an aged person, and money laundering, in violation of Louisiana Revised Statutes 51:703(A), 51:712, 51:723(A), 14:67(A), 14:67(B)(1), 14:67.21(C)(1), and 14:230(B)(4) and (E)(4).

3. The counts of the criminal indictments to which Urrea pleaded guilty alleged, among other things, that, from August 2008 through April 2011, Urrea held himself out as a "registered securities dealer" and misappropriated over $200,000 from nine individuals, including the elderly, by means of fraudulent conduct, practice, or representation, and with intent to permanently deprive funds. Urrea's theft was in connection with the purchase or sale of securities.

4. On September 17, 2012, Urrea was sentenced to five years imprisonment and five years of probation. Urrea was also ordered to make restitution to all victims in the sum of $247,550, and was prohibited from representing individuals in trading commodities and stocks.

III.

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

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

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

IV.

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

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

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

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary